Technical bulletin 2017/1

January to March 2017

AUDIT SCOTLAND

Prepared by the Technical Services Unit
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Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

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Foreword

Technical bulletins are prepared by Audit Scotland's Technical Services Unit (TSU), and approved by the Assistant Auditor General, to provide external auditors appointed by the Accounts Commission and Auditor General for Scotland with

- information on the main public sector technical developments in the quarter that are relevant to their audit appointment
- guidance from the TSU on any emerging risks identified in the quarter.

Technical bulletins are available to external auditors from Audit Scotland's *Technical reference library,* and published on the Audit Scotland website so that audited bodies and other stakeholders can access them.

It is important that auditors read this technical bulletin promptly so they are familiar with the information and guidance provided. The auditor action checklist section at the end of each chapter should be completed by a senior member of the audit team.

The articles on technical developments are intended to highlight the key points that the TSU considers external auditors require to be aware of. It may still be necessary for auditors to read the source material where greater detail is required. The documents referred to in the articles can be obtained by using the hyperlinks, where available. They are also available to external auditors from Audit Scotland's *Technical reference library*.

While auditors act independently, and are responsible for their own conclusions and opinions, the TSU has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement. Consistency in similar circumstances is important and paragraph 108 of **Audit Scotland's *Code of audit practice* therefore states that auditors should normally follow TSU guidance.** This means that auditors are expected to follow the guidance or provide a reasonable explanation as to why not. Auditors should advise the TSU promptly if they intend not to follow guidance provided in this technical bulletin on an emerging risk.

The TSU encourages feedback on this technical bulletin. Comments should be sent to pobrien@audit-scotland.gov.uk.

More in-depth and extensive guidance is provided in separate technical guidance notes published by the TSU. Technical guidance notes published in the quarter are referred to in this technical bulletin, and can be obtained by using the hyperlinks to the Audit Scotland website.

Headlines

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Cross-sectoral chapter

Introduction

This chapter contains technical developments and guidance from the TSU on emerging risks in the quarter that are relevant to all sectors.

It should be read by all external auditors. Information on developments and guidance from the TSU in the quarter that are relevant to only one sector are covered in the relevant sector-specific chapter.

Auditing developments

Report on audit quality control procedures

1. The Financial Reporting Council (FRC) has issued a report setting out the findings from a thematic review of quality control policies and procedures in the six largest UK audit firms. The report highlights areas of good practice as well as areas where improvements can be made.

2. Some firms have set out their audit quality procedures using the following 'three lines of defence' model
   - The first line of defence includes the selection of an appropriate audit team, reviews of work by more senior team members, access to technical support, and technical reviews of financial statements.
   - The second line of defence is the functions that oversee audit quality management, e.g. leadership responsibilities for audit quality, the audit methodology, resource management, as well as the recruitment, training and appraisal of staff.
   - The third line of defence is the functions that provide independent assurance, e.g. internal quality monitoring.

3. The report highlights the importance of auditors consulting with technical support on accounting and auditing matters. It explains that consultation
   - improves the application of professional judgement
   - aids consistency of approach
   - assists the appropriate application of professional standards
   - facilitates meaningful discussion and challenge which should result in more robust, defensible and better documented audit evidence.

4. The review found that audit teams were using the firms' consultation processes appropriately, and clearly documenting the conclusions of these consultations.

5. All firms' audit methodologies require a number of audit procedures to evaluate the overall presentation of the annual report and accounts. These procedures include
   - completing disclosure checklists
   - reviews by members of the audit team
   - obtaining a technical review from an independent reviewer with specific accounting technical expertise.
6. The responsibilities of the individuals involved in these procedures varied between firms and, in some cases, it was not clear whether these responsibilities were appropriate. Lines of responsibilities may therefore become confused and errors may not be identified.
7. The report notes differences in the structure of the firms' functions in respect of the independent technical review. Differences that may affect the quality and effectiveness of the reviews included
   - the types of audits where the financial statements are required to be subject to technical review
   - the information received by the technical reviewer
   - the responsibilities for dealing with the points raised by the reviewer.

Report on data analytics

8. The FRC has also issued a report on the findings from an audit quality thematic review on the use of audit data analytics (ADAs) which focusses on good practice in the development of ADAs at the six largest UK audit firms.
9. ADA is defined in the review as the science and art of discovering and analysing patterns, deviations and inconsistencies, and extracting other useful information in the data underlying or related to the subject matter of an audit through analysis, modelling and visualisation for the purpose of planning and performing the audit.
10. The review identified ADA that has been implemented to
    - analyse all transactions in a population, stratify that population and identify outliers for further examination
    - re-perform calculations relevant to the financial statements
    - match transactions as they pass through a processing cycle
    - assist in segregation of duties testing
    - compare entity data to externally obtained data
    - manipulate data to assess the impact of different assumptions.
11. Many of these standard ADA tools employ data visualisation techniques. Graphs, plots and information graphics may be used to enable patterns, trends, correlations and outliers to be identified more easily. In addition they may also be useful in communicating insights arising from the ADA work to the audit committee.

12. Some firms are at an early stage in considering further ADA techniques, including continuous control monitoring, benchmarking of data between audit clients at a transactional level, and unstructured data analysis (e.g. the content of emails).

13. Section 1.4 of the report summarises the findings from review, with further details set out in section 2. For example findings include

- The use of data analytics in the audit is not as prevalent as the market might expect. Pressure on firms to promote the use of ADA techniques may result in the pace of development and usage being overemphasised.
- Audit quality can be enhanced through the use of data analytics. ADA techniques can provide audit evidence that is more focused to the audit risks and provide useful insights to an entity's management and the audit committee.
- Audit teams need to have a clear understanding of the purpose of the ADA technique within the audit methodology.

Proposed revisions to ISA (UK) 250

14. The FRC has issued a consultation paper on proposed revisions to ISA (UK) 250 Section A Consideration of laws and regulations in an audit of financial statements to reflect recent revisions to the international ISA 250.

15. The revisions to ISA 250 were in response to changes to the international ethics code which addressed the professional accountant's responsibility in relation to non-compliance with laws and regulations (NOCLAR). The limited amendments are intended to address inconsistencies of approach between the NOCLAR provisions in the revised ethics code and the ISAs.

16. The proposed consequential amendments to ISA (UK) 250

- clarify the requirement regarding the auditor's determination of whether to report identified or suspected NOCLAR to an appropriate authority outside the entity
- highlight that the auditor may have additional responsibilities under law, regulation or relevant ethical requirements
- enhance the consideration of the implications of NOCLAR on the audit, e.g. the reliability of management's representations.

17. Comments should be sent to AAT@frc.org.uk by 26 May 2017.

Accounting developments

Management commentary

New report on business model reporting

18. The Financial Reporting Lab has issued Business model reporting which summarises good practice in reporting information on an entity's business model.

19. As no commonly agreed definition currently exists, this report defines the term business model as being what the organisation does, how it does it, and how it currently creates economic value. The report contrasts a business model with a business strategy which is concerned with where the organisation is going and how it intends getting there.

20. The report recommends that business model disclosures in the annual accounts (including a local authority' management commentary) should describe

- how the body generates or preserves value over the longer term
- what the body does and why
- how the body is structured
- the nature of the relationships, resources and other inputs that are necessary for the success of the business.

21. Good practice in the presentation of business model disclosures includes the following

- The appropriate location is towards the front of the strategic report (or equivalent report) as it provides context and understanding for the other narrative and financial information.
- Disclosures should be written in plain, clear, concise and factual language.
- Information is best communicated through a combination of narrative and infographics, tables and charts.

Other developments

Treasury management

Consultation on treasury management code

22. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued a consultation paper to seek views on whether the current edition of the *Treasury management in the public services code of practice* should be amended.

23. The consultation paper includes questions on whether

- each public body has adopted the treasury management code and if any practical implementation issues have been experienced
- the principles in the code are relevant to each body
- there are areas not fully covered by the principles.

24. Comments are required to be sent to mandy.bretherton@cipfa.org by 21 April 2017. CIPFA will then hold a further consultation on proposed changes to the code which are expected to apply from 2018/19.

TSU contact for cross-sector chapter

25. The contact in the TSU for this chapter is Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Local authority sector

Introduction

This chapter contains information on the main technical developments, and guidance from the TSU on any emerging risks, in the quarter that are relevant to the local authority sector.

It should be read by external auditors with appointments in the local authority sector. Auditors should also read the cross-sectoral chapter.

Accounting developments

General accounting

2016/17 code guidance notes

26. CIPFA has issued guidance notes to assist in understanding the accounting requirements of the 2016/17 *Code of practice on local authority accounting in the UK* (the accounting code). The guidance notes provide background to the 2016/17 accounting code's requirements and include detailed illustrations, but are not prescriptive.

27. The main changes in the guidance notes are to Module 3 (sections C to I) to reflect the
    - new formats and reporting requirements for the comprehensive income and expenditure statement and the movement in reserves statement
    - introduction of the new expenditure and funding analysis required by Code paragraphs 3.4.2.96 to 3.4.2.98.

28. Page 351 of the guidance notes provides an illustration of the expenditure and funding analysis. Code paragraph 3.4.2.95 requires that due prominence be given to the expenditure and funding analysis in accordance with the needs of users. This means each authority can decide where it is best positioned. The guidance notes have positioned the expenditure and funding analysis before the main statements. However, a footnote clarifies that the status of the analysis is that of a note to the financial statements.

29. Module 3 also includes the accounting code's amendments to reflect the changes to *IAS 1 Presentation of financial statements* under the International Accounting Standards Board's (IASB) *Disclosure initiative*, including
    - guidance on ordering the notes covered by Code paragraph 3.4.2.84
    - the presentation of sub-totals referred to at Code paragraph 3.4.2.61.

Property, plant and equipment

Revised reference manual

30. CIPFA has issued a revised version of its *Local authority capital accounting - a reference manual for practitioners* provides guidance on local authority capital accounting. The manual focuses on the practical application of the accounting theory set out in the accounting code.

31. This is the second edition of the manual. The previous edition has been updated to reflect the requirements of *IFRS 13 Fair value measurement*. The manual is in the following three parts

- The first part of the manual is a reference section organised by topic which is based on the most frequently asked questions on capital accounting received by CIPFA.
- Part 2 contains fictional stories about two assets. The first shows events happening to a building over an authority's eight year ownership, while the second sets out the treatment of leased vehicles.
- Part 3 provides a glossary of accounting terms used in the manual.

Highways network asset

Update on move to current value

32. Technical bulletin 2016/4 (paragraph 47) referred to the decision of the CIPFA/LASAAC Local Authority Code Board to postpone the change to measuring the highways network asset at current value planned for 2016/17.

33. CIPFA/LASAAC has subsequently issued a statement to advise that it has decided not to proceed with the change in measurement basis. The board will give further consideration to this matter if there is clear evidence that the benefits outweigh the costs. An Update to 2016/17 accounting code had previously been issued to remove references to the change in measurement basis from the 2016/17 code.

34. In addition, CIPFA has issued Highways network asset briefing number 4 which clarifies that the infrastructure class of assets will continue to be accounted for as in previous years and it will include the components of the highways network asset. There are therefore no reporting provisions relating to the highways network asset for the 2016/17 financial year.

35. As a result of the above, module 2 of technical guidance note 2016/10(LA), and references in the 2016/17 audit planning guidance, on auditors' responsibilities in respect of the highways network asset no longer apply.

Pension funds

Illustrative 2016/17 financial statements

36. CIPFA has issued the *2016/17 LGPS fund accounts – example accounts and disclosure checklist* to illustrate the financial statements of local government pension scheme (LGPS) pension funds.

37. The publication provides an example set of accounts that meet the minimum requirements of the accounting code in respect of LGPS accounts. It sets out a fund account and a net assets statement as well as information to be disclosed in the notes.

38. The main change for the 2016/17 example pension fund accounts is the extension of the fair value disclosures required under section 2.10 of the accounting code to pension funds. The additional disclosures required are included in note 16 which deals solely with items at fair value and which now includes property investments.

39. Other changes made to the example pension fund accounts include the following

- Note 11 now includes an analysis of investment management expenses in line with CIPFA's *Accounting for local government pension scheme management expenses* (2016).
- The net assets statement along with relevant notes have been amended to align with new investment classifications required by the accounting code.
- An additional disclosure note (note 25a) covering remuneration of key management personnel has been included in related party transactions.

40. The publication also includes a disclosure checklist that identifies the accounting code's requirements in relation to pension funds.

Other developments

Housing benefit

Guidance on 2016/17 subsidy claims

41. The Department for Work and Pensions (DWP) has issued a letter and notes on completing the 2016/17 subsidy claim to provide guidance on the housing benefit (HB) subsidy claim for 2016/17.

42. The letter contains details of the amounts paid for 2016/17 in respect of administration subsidy and interim benefit subsidy received. The deadlines for receipt of the

- pre-certified claim to the DWP and external auditors is 30 April 2017
- the certified claim by the DWP is 30 November 2017.

2016/17 HB COUNT modules

43. Public Sector Audit Appointments has issued the following modules of the 2016/17 HB COUNT approach

- Module 2 contains a checklist to help auditors ensure that the authority's system is using the correct benefit parameters to calculate benefit entitlement and for the authority to claim the correct amount of subsidy.
- Module 3 comprises workbooks to be completed for detailed testing, incorporating step-by-step guidance and a test result summary.

44. Module 1 has also been issued and provides an overview of the approach, but this is superseded in Scotland by guidance from the TSU.

45. For 2016/17, the key changes are to reflect DWP changes to the regulations and subsidy order, including reductions to both the benefit cap and the maximum period a claim can be backdated.

46. An e-learning package setting out the principles of the HB COUNT approach to the certification of HB subsidy claims for 2016/17 has also been issued.

2016/17 funding

47. The DWP has issued HB circular S2-2017 Final new burdens payment 2016/17 for the Real Time Information Bulk Data Matching initiative to provide details of funding to help meet the costs incurred in implementing the *Real time information bulk data matching initiative* in 2016/17.

2017/18 uprating

48. The DWP has issued HB circulars A12/2016 Housing benefit: Uprating 2017/18 and A1/2017 War pensions: uprating 2017/18 to advise of the benefits rates from April 2017.

49. A12/2016 contains specific advice for local authorities that apply percentage increases to uprate income from other social security benefits. As some of the rates have been uprated by different indices, authorities are required to consider whether applying standard percentages will result in correct determinations.

2017/18 administration subsidy

50. The DWP has issued HB circular S10/2016: 2017/18 Housing benefit administration subsidy arrangements for English, Scottish and Welsh local authorities to provide details of the HB administration subsidy for Scottish local authorities for 2017/18.

Prudential framework

Consultation on revising prudential code

51. CIPFA has issued a consultation paper to seek views on whether the prudential code should be amended. The consultation paper includes questions on whether

- the objectives of the prudential code are still relevant, and whether it achieves its objectives
- the code's scope should be extended to cover arms-length external organisations and group entities
- the code can be strengthened to encompass the risks related to increasing commercial activities and in respect of strategic planning elements
- the indicators can be improved to enhance the assurance they provide.

52. Comments are required to be sent to mandy.bretherton@cipfa.org by 21 April 2017. CIPFA will then hold a further consultation on proposed changes to the code which are expected to apply from 2018/19.

TSU contacts for local authority chapter

53. The contacts in the TSU for this chapter are

- Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.
- Anne Cairns, Manager – Benefits (Technical) - 0131 625 1926 or acairns@audit-scotland.gov.uk (for housing benefit).

Central government chapter

Introduction

This chapter contains technical developments and guidance from the TSU on emerging risks that are relevant to the central government sector.

It should be read by external auditors with appointments in the central government sector. It should also be read by auditors with appointments in the health sector and further education sector as most of the articles also apply to those sectors. Auditors should also read the cross-sectoral chapter.

Auditing developments

Technical guidance notes

Auditing 2016/17 annual report and accounts

54. The TSU has published Audit of 2016/17 annual report and accounts (central government) - technical guidance note 2017/1(CG) to provide guidance to support auditors in planning and performing the audit of the 2016/17 central government annual report and accounts.

55. The technical guidance note comprises

- an overview module including the financial reporting framework, key auditing standards, and presentation of financial statements
- modules 1 to 5 on financial statement areas, e.g. property, plant and equipment, financial instruments, group financial statements
- module 6 on the regularity of expenditure and income
- module 7 on the performance report, governance statement, and remuneration and staff report. This module has been updated to provide guidance on
  - the new opinions referred to later at paragraph 62
  - applying the requirements of the FReM to Scottish bodies as a result of the FReM amendment referred to later at paragraph 68.
- module 8 on charitable NDPBs.

56. The modules highlight the main risks of misstatement in each area, explain the correct treatment, and set out actions for auditors to assess whether the body has followed the required treatment. Following extensive consultation with all auditors, the technical guidance note represents an agreed position on a range of complex technical issues and is a key document as auditors plan and perform the audit of 2016/17 central government annual report and accounts.

57. For the purposes of the Audit Scotland website, all the modules have been combined into one document. The individual modules are also available from the relevant subject pages on the central government site of the *Technical reference library*. There is also a module containing a summary of the risks of misstatement available as a word document which auditors may use to satisfy themselves that their audit programmes adequately address the highlighted risks.

58. While auditors are responsible for their own conclusions and opinions, consistency in similar circumstances is important. Auditors should read the technical guidance note so they are familiar with the guidance provided. It is important that auditors follow the actions set out, subject to local judgements on materiality, to ensure that all auditors adopt a consistent approach to common risks.

2016/17 model independent auditor's reports

59. The TSU has issued 2016/17 Independent auditor's report (central government) - technical guidance note 2017/4(CG) to provide auditors with the model independent auditor's reports which should be used for the 2016/17 annual report and accounts of central government bodies. The technical guidance note also provides application guidance on their use.

60. In the interests of consistency, auditors are required to use the relevant model report in appendices 1 to 5 of the technical guidance note as a condition of their audit appointment. The only exceptions to using the wording in each model are cases where there are group accounts or any amendments required to tailor the terminology to reflect local circumstances.

61. The models for 2016/17 are required to comply with *ISA (UK&I) 700 The independent auditor's report on financial statements*. This standard will be replaced from 2017/18 by the new *ISA (UK) 700 Forming and opinion and reporting on financial statements*, which contains a revised structure for the independent auditor's report. Although ISA (UK) 700 does not yet formally apply, the model reports for 2016/17 have been revised to follow the structure set out in that new standard, while also complying with the minimum requirements of ISA (UK&I) 700.

62. The models have also been revised to reflect the new reporting requirements for 2016/17 for auditors to express opinions on whether

- the performance report has been properly prepared in accordance with the accounts direction
- the governance statement is consistent with the financial statements and has been properly prepared in accordance with the accounts direction.

63. Any proposed modifications to any audit opinion or conclusion in the model reports, or the inclusion of 'emphasis of matter' or 'other matter' paragraphs, should be discussed with the TSU in advance of finalising the report.

64. Auditors should use this technical guidance note when reporting on 2016/17 audits. They should complete for each report the checklist at Appendix 6 which provides a list of the key auditor actions.

2016/17 GBS account information

65. The TSU will obtain information on account balances at 31 March 2017 for central government bodies from the Government Banking Service (GBS) and distribute them to relevant auditors.

66. The GBS has confirmed that the arrangements for obtaining 2016/17 account balances are unchanged.

Accounting developments

General accounting

Amendments to the 2016/17 FReM

67. HM Treasury has issued a revised version of the 2016/17 Government financial reporting manual (the FReM).

68. The most significant change from the previous version is to paragraph 5.1.4 which has been expanded to clarify the application of FReM requirements to Scottish bodies. The format of accounts of Scottish bodies requires to be based on the principles, but not the detail, set out in chapter 5 of FReM. The clarification explains that the accounts of these bodies should meet disclosure requirements which originate in

- accounting standards
- Companies Act application as set out in the FReM
- Scottish legislation
- the *Scottish public finance manual* (SPFM).

69. Guidance on the impact of the clarification added to FReM paragraph 5.1.4 is provided in technical guidance note 2017/1(CG) (module 7) and is summarised as follows

- The requirements in the FReM for disclosures in the remuneration and staff report on expenditure on consultancy and data on off-payroll arrangements do not apply to Scottish bodies.
- There are a number of FReM disclosure requirements for the parliamentary accountability report that do not directly apply in Scotland, but are replaced by equivalent requirements in the SPFM, e.g. losses and special payments.

70. The requirement at FReM paragraph 5.3.25 for bodies to disclose information comparing the remuneration of the highest paid director with the median remuneration of the body's staff is not a Companies Act requirement, and there is no equivalent requirement in Scottish legislation or, currently, the SPFM. However, the Scottish Government has confirmed to Audit Scotland that they consider this disclosure should apply to Scottish bodies and has indicated that the SPFM will be amended or other guidance issued to reflect this requirement.

71. This is also the case for information on sickness absence.

72. Other amendments to the FReM are the following

- Paragraph 5.4.23 contains a new requirement for the notes on expenditure to include a brief summary of staff costs with a reference to the more detailed disclosures in the remuneration and staff report.
- Paragraph 5.4.22 has been added to emphasise that the notes to the accounts should include disclosures required under *IFRS 8 Operating segments*. This is in response to evidence of some bodies not complying with IFRS 8's requirements.

73. Auditors should ensure they refer to this revised version of the FReM, as interpreted by technical guidance note 2017/1(CG), when auditing the 2016/17 annual report and accounts.

2016/17 disclosure checklists

74. The National Audit Office (NAO) has issued the 2016/17 FReM disclosure guide for financial statements which is designed to ensure that bodies covered by the FReM have prepared their 2016/17 annual report and accounts in the appropriate form and have complied with FReM disclosure requirements.

75. The guides are cross-referenced to the 2016/17 FReM, individual financial reporting standards, and the *Companies Act 2006.* Auditors will need to generate a tailored checklist by selecting the criteria that are material to their audited body.

76. While the guide is designed primarily for the NAO's internal use, auditors in Scotland may also find it helpful.

77. The NAO has also issued the *2016/17 FReM disclosure guide for annual reports*. The TSU has amended this guide for application to Scottish bodies in line with technical guidance note 2017/1(CG), and it is available from the *Technical reference library*. Auditors should ensure they use the amended guide rather than the NAO original which does not reflect Scottish requirements.

2017/18 FReM

78. Treasury has issued the 2017/18 FReM. It applies EU adopted IFRS and Interpretations in effect for accounting periods commencing on or after 1 January 2017.

79. There are no changes from the 2016/17 FReM.

Remuneration and staff report

Preparation guidance for 2016/17

80. The Cabinet Office has issued EPN 492 2016/17 Disclosure of salary, pension and compensation information to provide guidance on the preparation of the pay pension and compensation disclosures in remuneration and staff report for 2016/17. Example disclosures are provided at Annex 13C.

81. There are no significant changes to the remuneration disclosures set out for 2015/16. However, this guidance does not reflect the application of the FReM's requirements to Scottish bodies in line with FReM paragraph 5.1.4.

82. Page 1 of the annex provides a table setting out the single total figure of remuneration for each senior officer. Remuneration disclosures include

- information on the pay and pension packages of the senior management team
- the median remuneration of all staff and the ratio between this and the mid-point of the banded remuneration of the highest paid director
- the number of exit packages for all staff by cost band, broken down by the number of compulsory redundancies and the number of other departures agreed
- compensation payments made to senior management.

83. The disclosure of the median remuneration of all staff and the ratio between this and the mid-point of the banded remuneration of the highest paid director is illustrated on page 3 of the annex.

84. The following disclosures required in respect of pensions are shown on page 5 of the annex

- Accrued pension and lump sum as at 31 March 2017 disclosed on £5,000 bands, which should be the pension that the individual would receive if that was their last day in service.
- The real increase in pension and lump sum, i.e. the increase after considering inflation, in bands of £2500.
- The cash equivalent transfer value (CETV) to the nearest £1,000, and the real increase in CETV that is funded by the employer.

85. Paragraph 13.1.11 provides guidance in cases where an officer is not in post for the whole year. Bodies should disclose the date of appointment for individuals appointed during the reporting year and the last day of service for those who left. Disclosures should only relate to the period during which they were in a post, but the full year equivalent of the salary should also be disclosed. An illustration is provided at paragraph 13.1.12.

86. Illustrative disclosure are also provided

- on page 8 of the annex for the number of exit packages for all staff by cost band, broken down by the number of compulsory redundancies and the number of other departures agreed. For staff who left under the voluntary terms, the cost to be used must include any top-up to compensation provided by the employer to buy out the actuarial reduction on an individual’s pension
- on page 7 in respect of compensation payments made to senior management.

87. Auditors should refer to this guidance when auditing the remuneration and staff report in the 2016/17 annual report and accounts.

Provisions

2016/17 discount rates

88. HM Treasury has issued PES(2016)10 to announce the discount rate for post-employment benefits liabilities and general provisions as at 31 March 2017.

89. The discount rate for post employment benefits, including early departure provisions, will change from 1.37 % real to 0.24% real from 31 March 2017. The appropriate interest rate to be used in assessing interest costs of scheme liabilities for 2016/17 is 2.80%. The financial assumptions, based on market conditions, related to post employment benefit discount rates are set out in an annex. Funded schemes within central government should use a discount rate based on financial assumptions at 31 March each year, rather than these assumptions which are as at 30 November.

90. The real discount rates to be applied to provisions recognised in accordance with IAS 37 as at 31 March 2017 are as follows

- The short term rate (for cash-flows up to 5 years from the statement of financial position date) is minus 2.70%.
- The medium term rate (between 5 and 10 years) is minus 1.95%.
- The long term rate (more than 10 years) is minus 0.80%.

91. Auditors should refer to this paper when reviewing the discount rates applied to provisions in 2016/17 financial statements.

Governance statement

92. The Scottish Government has issued a revised version of On board - a guide to members of statutory boards which provides information on the role of board members of public bodies in Scotland. The guidance applies to those appointed under statute to be members of the boards of public bodies.

93. The main changes are to extend the scope of the guide to cover most non-ministerial offices and public corporations as well as non departmental public bodies, and to reflect changes since the previous edition was published in 2015 such as the *Community Empowerment (Scotland) Act 2015.*

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action required by paragraph 58 in respect of technical guidance note 2017/1(CG)?			
2 Have you carried out the action required by paragraph 64 in respect of 2016/17 model independent auditor's reports?			
3 Have you carried out the action recommended at paragraph 73 in respect of the 2016/17 FReM?			

	Yes/No/N/A	Initials/date	W/P ref
4 Have you carried out the action recommended at paragraph 87 in respect of the remuneration and staff report?			
5 Have you carried out the action recommended at paragraph 91 in respect of 2016/17 discount rates?			

TSU contacts for central government chapter

94. The contacts in the TSU for this chapter are

- Neil Cameron, Manager - Central Government and Health (Technical) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.
- Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or hcobb@audit-scotland.gov.uk.

Health chapter

Introduction

This chapter contains technical developments that are relevant to the health sector.

It should be read by external auditors with appointments in the health sector. Auditors should also read the central government sector and cross-sectoral chapter.

Auditing developments

Technical guidance notes

Auditing 2016/17 annual report and accounts

95. The TSU has published Audit of 2016/17 annual report and accounts (health) - technical guidance note 2017/2(H) to provide guidance to support guidance in planning and performing the audit of the 2016/17 health annual report and accounts.

96. The technical guidance note comprises

- an overview module including the financial reporting framework, key auditing standards, and presentation of financial statements
- modules 1 to 3 on financial statement areas, e.g. property, plant and equipment
- module 4 on the regularity of expenditure and income
- module 5 on the performance report, governance statement, and remuneration and staff report. This module has been updated to provide guidance on
  - the new opinions referred to later at paragraph 102
  - applying the requirements of the FReM to Scottish health boards as a result of the FReM amendment referred to at paragraph 68.

97. The modules highlight the main risks of misstatement in each area, explain the correct treatment, and set out actions for auditors to assess whether the board has followed the required treatment. Following extensive consultation with all auditors, the technical guidance note represents an agreed position on a range of complex technical issues and is a key document as auditors plan and perform the audit of 2016/17 health annual report and accounts.

98. For the purposes of the Audit Scotland website, all the modules have been combined into one document. The individual modules are also available from the relevant subject pages on the health site of the *Technical reference library*. There is also a module containing a summary of the risks of misstatement available as a word document which may be used as a checklist.

99. While auditors are responsible for their own conclusions and opinions, consistency in similar circumstances is important. Auditors should read the technical guidance note so they are

familiar with the guidance provided. It is important that auditors follow the actions set out, subject to local judgements on materiality, to ensure that all auditors adopt a consistent approach to common risks.

2016/17 model independent auditor's reports

100. The TSU has issued [2016/17 Independent auditor's report (health) - technical guidance note 2017/3(H)] to provide auditors with the model independent auditor's reports which should be used for the 2016/17 annual report and accounts of health boards. The technical guidance note also provides application guidance on their use.

101. In the interests of consistency, auditors are required to use the relevant model report in appendices 1 to 2 of the technical guidance note as a condition of their audit appointment. The only exception to using the wording in each model is to tailor the terminology to reflect local circumstances.

102. As for central government bodies, the model reports have been revised to

- follow the structure set out in ISA (UK) 700
- reflect the new opinions on the performance report and governance statement.

103. Any proposed modifications to any audit opinion or conclusion in the model reports, or the inclusion of 'emphasis of matter' or 'other matter' paragraphs, should be discussed with the TSU in advance of finalising the report.

104. Auditors should use this technical guidance note when reporting on 2016/17 audits. They should complete for each report the checklist at Appendix 3 which provides a list of the key auditor actions.

105. The technical guidance note also provides an assurance statement for the consolidation schedules at Appendix 4. Auditors should complete the auditor action checklist at Appendix 4.

Review of central work on CNORIS

106. The TSU is currently undertaking a review of the work carried out by the NHS Central Legal Office (CLO) relating to the *Clinical negligence and other risks indemnity scheme* (CNORIS). The objective of the review is to establish the extent to which the information prepared using the work of the CLO, as a management expert under *ISA (UK&I) 500 Audit evidence*, can be used as audit evidence.

107. The TSU will also evaluate the appropriateness of the methodology adopted by the Scottish Government to establish the total national liability for CNORIS. The review will focus on the estimation of the liability as at 31 March 2017.

108. The TSU will then provide auditors with the outcome of the reviews to

- inform auditors' evaluation of the relevance and reliability of the information prepared by the CLO as audit evidence

- provide assurance on the methodology used in the preparation of the CNORIS figures as at 31 March 2017 which are provided by the Scottish Government to NHS boards.

Accounting developments

General accounting

2016/17 accounts manual

109. The Scottish Government Health and Social Care Directorates (SGHSCD) has issued the *2016/17 NHS board manual for annual report and accounts* to complement the guidance contained in the 2016/17 FReM. An initial version issued in December 2016 has been replaced by an updated version which reflects the changes in the revised version of the FReM.

110. The main changes included in the updated version of the accounts manual compared with 2015/16 are summarised in the following paragraphs. Auditors should refer to this manual when auditing health boards' 2016/17 annual report and accounts.

Foreword

111. Paragraph 1 has been amended to clarify that the accounts manual does not supersede the FReM, and that boards are responsible for ensuring that their accounts are compliant with the requirements of the FReM.

Financial statements

112. The covering letter that accompanies the revised accounts manual

- clarifies that the title of the statement of comprehensive net expenditure should not include reference to the summary of resource outturn (SoRO), and the SoRO should not be described as a statement
- advises the term net expenditure, rather than net operating costs, should be used in the annual accounts.

113. The covering letter also provides a form of words to be used in the note on pension cost disclosures.

Performance report

114. Pages 10 and 11 have been amended as a result of disclosures being moved from the accountability report to the performance analysis section of the performance report. The disclosures are

- performance against the Scottish Government payment policy target
- pension liabilities
- details of events after the reporting period.

Remuneration and staff report

115. The table on page 26 covering the fair pay disclosure has been amended to include the range of staff remuneration required by FReM paragraph 5.3.25.

116. The staff report on pages 27 to 33 has been amended to

- include the higher paid employees and staff costs disclosure previously included at note 2
- remove the requirements to disclose information on off payroll arrangements and expenditure on consultancy.

Parliamentary accountability report

117. Pages 31 and 32 have been amended to reflect the requirement for a parliamentary accountability report to be included in the accountability report. The parliamentary accountability report should include the disclosures required by the SPFM.

Property, plant and equipment

2016/17 capital accounting manual

118. The SGHSCD has issued the *2016/17 NHS capital accounting manual* (CAM) to interpret the accounting guidance contained in the 2016/17 FReM on capital accounting issues in the NHS.

119. There are no significant changes from the 2015/16 CAM.

120. Auditors should refer to the CAM when auditing property, plant and equipment in 2016/17 annual report and accounts.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 99 in respect of technical guidance note 2017/2(H)?			
2 Have you carried out the action required by paragraph 104 in respect of 2016/17 model independent auditor's reports?			
3 Have you carried out the action recommended at paragraph 110 in respect of the 2016/17 NHS board manual for annual report and accounts?			
4 Have you carried out the action recommended at paragraph 120 in respect of the 2016/17 capital accounting manual?			

TSU contact for health chapter

121. The contact in the TSU for this chapter is Neil Cameron, Manager - Central Government and Health (Technical) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.

Fraud and irregularities

Introduction

This chapter contains a summary of fraud cases and other irregularities arising at audited bodies that have recently been reported by auditors to the TSU.

Auditors should consider whether the weaknesses in internal control that facilitated each fraud may apply at their audited bodies and take the appropriate action.

Expenditure and income

122. An administrative assistant employed in a council criminal justice service embezzled £5,000 over a seven year period.

Key features

The perpetrator

- submitted false expense claims for the valeting of council vehicles
- failed to bank cash income
- requested cash advances in addition to the petty cash float.

The fraud was possible as

- the employee had sole control of the petty cash
- team managers did not have access to the ledger to allow them to identify discrepancies in their budgets
- the employee intimidated other employees to sign blank expense claims which she then authorised without supporting receipts.

The fraud was identified when internal audit followed up concerns raised by a whistle-blower.

The employee was prosecuted and received a community payback order. All criminal justice staff have since received financial training, and team managers now have access to the ledger to allow them to monitor their budgets.

TSU contact for fraud and irregularities chapter

123. The contact in the TSU for this chapter is Anne Cairns, Manager – Benefits (Technical) - 0131 625 1926 or acairns@audit-scotland.gov.uk.

Technical Services Unit

Audit Scotland's Technical Services Unit (TSU) informs the professional judgement of appointed external auditors on technical matters and encourages the proper exercise of professional scepticism to improve the quality of the audit delivered to the Accounts Commission and Auditor General for Scotland. The TSU provides authoritative guidance and practical assistance to support appointed auditors in carrying out their responsibilities under the *Code of audit practice* to

- provide an opinion on audited bodies' financial statements and, where required, the regularity of transactions
- review and report on other information published with the financial statements, including governance statements and remuneration reports
- examine and report on approved grant claims and other returns submitted by local authorities
- review and report on whole of government accounts returns.

Contact details for relevant TSU staff are included at the end of each chapter.

Feedback on technical bulletins is encouraged and should be sent to

pobrien@audit-scotland.gov.uk

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Technical bulletin 2017/2

April to June 2017

AUDIT SCOTLAND

Prepared by Audit Strategy
21 June 2017

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Foreword

Technical bulletins are prepared by Audit Scotland's Audit Strategy business group, and approved by the Assistant Auditor General, to provide external auditors appointed by the Accounts Commission and Auditor General for Scotland with

- information on the main public sector technical developments in the quarter that are relevant to their audit appointment
- guidance from Audit Strategy on any emerging risks identified in the quarter.

Technical bulletins are available to external auditors from Audit Scotland's *Technical reference library,* and published on the Audit Scotland website so that audited bodies and other stakeholders can access them.

It is important that auditors read this technical bulletin promptly so they are familiar with the information and guidance provided. The auditor action checklist section at the end of each chapter should be completed by a senior member of the audit team.

The articles on technical developments are intended to highlight the key points that Audit Strategy considers external auditors require to be aware of. It may still be necessary for auditors to read the source material where greater detail is required. The documents referred to in the articles can be obtained by using the hyperlinks, where available. They are also available to external auditors from Audit Scotland's *Technical reference library*.

While auditors act independently, and are responsible for their own conclusions and opinions, Audit Strategy has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement. Consistency in similar circumstances is important and paragraph 108 of **Audit Scotland's *Code of audit practice* therefore states that auditors should normally follow Audit Strategy guidance.** This means that auditors are expected to follow the guidance or provide a reasonable explanation as to why not. Auditors should advise Audit Strategy promptly if they intend not to follow guidance provided in this technical bulletin on an emerging risk.

Audit Strategy encourages feedback on this technical bulletin. Comments should be sent to pobrien@audit-scotland.gov.uk.

More in-depth and extensive guidance is provided in separate technical guidance notes published by Audit Strategy. Technical guidance notes published in the quarter are referred to in this technical bulletin, and can be obtained by using the hyperlinks to the Audit Scotland website.

Headlines

This chapter provides brief headlines for the articles on technical developments and guidance in this technical bulletin, classified by the audit year to which it relates, and referenced to the paragraphs containing the main article.

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Cross-sectoral chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Strategy on any emerging risks, in the quarter that are relevant to all sectors.

It should be read by all external auditors. Information on developments and guidance from Audit Strategy in the quarter that are relevant to only one sector are covered in the relevant sector-specific chapter.

Auditing developments

Proposed changes to auditing accounting estimates

1. The International Auditing and Assurance Standards Board has issued an exposure draft of proposed changes to *ISA 540 Auditing accounting estimates and related disclosures.* The exposure draft includes enhanced requirements for risk assessment procedures and the auditor's work effort in responding to the assessed risks of material misstatement in respect of the reasonableness of accounting estimates.

2. It also highlights that the auditor's identification and assessment of the risks of material misstatement, and the auditor's responses to those assessed risks, are affected by the following three factors which are incorporated throughout the exposure draft
   - complexity
   - the need for the use of judgment by management
   - estimation uncertainty.

3. The exposure draft also contains several key provisions that are designed to enhance the auditor's application of professional scepticism and consideration of the potential for management bias, including
   - enhanced risk assessment requirements
   - more granular requirements with respect to obtaining audit evidence
   - requirements to 'stand back' and evaluate the audit evidence obtained.

4. The Financial Reporting Council (FRC) will respond to the consultation and expects in due course to update its ISA (UK) 540 in line with the IAASB's final standard.

Accounting developments

General accounting

Discussion paper on disclosure

5. The International Accounting Standards Board (IASB) has issued a discussion paper under its *Principles of disclosure* project. The Discussion paper: Disclosure initiative - principles of disclosure considers the existing requirements in *IAS 1 Presentation of financial statements* with a view to either amending parts of it or creating a new disclosure standard (both options are referred to in the discussion paper as a general disclosure standard).

6. Paragraphs IN10 to IN15 provide a summary of the IASB's preliminary views. These include the disclosure principles that should be included in a general disclosure standard, and guidance on
   - the principles of effective communication
   - the location of accounting policies disclosures
   - formatting in the financial statements.

7. Paragraphs 1.5 to 1.8 of the discussion paper discuss the following three concerns around what the paper refers to as the disclosure problem
   - Financial statements do not provide enough relevant information.
   - Irrelevant information clutters the financial statements.
   - The information provided is ineffectively communicated.

8. The main causes of the disclosure problem appear to be entities having difficulties in applying judgement when deciding what information to disclose in financial statements and the most effective way to organise and communicate it. A lack of guidance on the content and structure of the financial statements, particularly regarding disclosures in the notes, contributes to these difficulties.

9. Paragraph 2.6 sets out the seven principles to help entities communicate information more effectively in the financial statements. They are that the information should be
   - entity-specific, as that is more useful
   - described as simply and directly as possible without a loss of material information and without unnecessarily increasing the length of the financial statements
   - organised in a way that highlights important matters, including providing disclosures in an appropriate order and emphasising the important matters within them
   - linked when relevant to other information in the financial statements or to other parts of the annual report to highlight relationships between pieces of information
   - not duplicated unnecessarily in different parts of the financial statements or the annual report

- provided in a way that optimises comparability among entities and across reporting periods without compromising the usefulness of the information
- provided in a format that is appropriate for that type of information, e.g. tables may be preferable for data-intensive information.

10. Other preliminary views in the discussion paper include the following
    - The term primary financial statements should be used to refer to the set of individual financial statements to differentiate them from the notes.
    - The role of the primary financial statements is to provide a structured and comparable summary of an entity's recognised assets, liabilities, equity, income and expenses.
    - The role of the notes (which should be defined as that part of the financial statements other than the primary financial statements) is to
      - provide further information necessary to disaggregate, reconcile and explain the items recognised in the primary financial statements
      - supplement the primary financial statements with other information that is necessary to meet the objective of financial statements.
    - When drafting standards in the future, rather than using the terms 'present' and 'disclose' on their own to specify the location of information in the financial statements, the intended location (i.e. 'in the primary financial statements' or 'in the notes') should also be specified.
    - Information necessary to comply with IFRS can be provided outside the financial statements if such information meets the following requirements
      - It is provided within the entity's annual report.
      - Its location outside the financial statements makes the annual report as a whole more understandable, the financial statements remain understandable and the information is faithfully represented; and
      - It is clearly identified and incorporated in the financial statements by means of a cross-reference that is made in the financial statements.
    - Accounting policies should be considered significant, and therefore be disclosed, if their disclosure is necessary for the primary users of the financial statements to understand the information in the financial statements.

11. Comments should be sent to commentletters@ifrs.org by 2 October 2017. The IASB will consider the comments received on the discussion paper before deciding whether to develop an exposure draft of proposed amendments to standards or non-mandatory guidance.

Framework for digital reporting

12. The Financial Reporting Lab has issued a report setting out a framework for future digitally-enabled corporate reporting. Characteristics of the framework set out in Digital future - a framework for future digital reporting include
    - the ability to upload or link information into reports and models

- the ability to search for relevant information and easily navigate reports.
- the corporate reports to
  - be easy to consume
  - require limited technical or specialist skill
  - be trusted as secure and authentic
  - facilitate the ability of entities to engage with their stakeholders.

13. Future reports from the LAB will consider how technologies might meet the needs of the framework.

Corporate governance developments

Revised public sector internal audit standard

14. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued a revised Public sector internal auditing standard (PSIAS) which applies from 1 April 2017. The PSIAS encompasses the mandatory elements of the Global Institute of Internal Auditors *International professional practices framework* with additional requirements and interpretations for the UK public sector.

15. The PSIAS comprises the following main sections
    - Section 3 states that the mission of internal audit is to enhance and protect organisational value by providing risk-based and objective assurance, advice and insight.
    - Section 4 defines internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations.
    - Section 5 sets out the core principles which articulate internal audit effectiveness. For an internal audit function to be considered effective, all principles should be present and operating effectively. They include demonstrating competence and due professional care; being objective and free from undue influence; aligning with the strategies, objectives, and risks of the organisation; and being appropriately positioned and adequately resourced.
    - Section 6 sets out the code of ethics.
    - Section 7 sets out the standards for the professional practice of internal auditing.

16. The PSIAS has been revised to reflect changes to the international standards. The changes include, for example, emphasising that safeguards are required to avoid conflicts of interest where the head of internal audit's role extends beyond internal auditing.

Other developments

Severance arrangements

17. The Scottish Government has issued a consultation paper to seek views on possible changes to severance arrangements in the Scottish public sector. This is as a result of new powers

conferred on Scottish Ministers in relation to capping and recovery of exit payments in devolved public sector bodies and existing powers that relate to exit payment terms.

18. Exit payment is the term used in the consultation to refer to any financial or non-financial transfer to an employee which does not represent remuneration for normal on-going activities that are part of their employment, e.g. cash lump sums, and early access to unreduced pension.

19. The UK Government's reform of public sector exit payments includes

- capping the total cost of an exit payment to £95,000
- recovering public sector exit payments when an individual on a salary of £80,000 or more returns to work in the public sector within 12 months
- reforming exit payment (severance) terms including imposing a maximum tariff for calculating exit payments of three weeks' pay per year of service, and a ceiling of 15 months on the maximum number of months' salary that can be paid.

20. Scottish Ministers can decide whether to adopt an exit payment cap and/or recovery measures similar to those being implemented by the UK Government or set a different level of cap and/or salary ceiling in relation to recovery provisions. They could also specify the types of payments to be included in that cap and/or recovery provisions.

21. Comments should be sent to severance-policy-for-scotland@gov.scot by 23 June 2017.

Audit Strategy contact for cross-sector chapter

22. The contact in Audit Strategy for this chapter is Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Local authority sector

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Strategy on any emerging risks, in the quarter that are relevant to the local authority sector.

It should be read by external auditors with appointments in the local authority sector. Auditors should also read the cross-sectoral chapter.

Auditing developments

Technical guidance notes

2016/17 model independent auditor's reports

23. Audit Strategy has issued 2016/17 Independent auditor's report (local authorities) - technical guidance note 2017/5(LA) to provide auditors with the model independent auditor's reports which should be used for the 2016/17 local authority annual accounts. The technical guidance note also provides application guidance on their use.

24. In the interests of consistency, auditors are required to use the relevant model report in appendices 1 to 4 of the technical guidance note as a condition of their audit appointment. The only exceptions to using the wording in each model are cases where amendments are required to tailor the terminology to reflect local circumstances.

25. The models for 2016/17 are required to comply with *ISA (UK&I) 700 The independent auditor’s report on financial statements*. This standard will be replaced from 2017/18 by the new *ISA (UK) 700 Forming an opinion and reporting on financial statements*, which contains a revised structure for the independent auditor's report. Although ISA (UK) 700 does not yet formally apply, the model reports for 2016/17 have been revised to follow the structure set out in that new standard, while also complying with the minimum requirements of ISA (UK&I) 700.

26. The models have also been revised to reflect the new reporting requirements for 2016/17 for auditors to express opinions on whether

    - the management commentary has been properly prepared in accordance with statutory guidance
    - the governance statement is consistent with the financial statements and has been properly prepared in accordance with the good governance framework.

27. Any proposed modifications to any audit opinion or conclusion in the model reports, or the inclusion of 'emphasis of matter' or 'other matter' paragraphs, should be discussed with the Audit Strategy in advance of finalising the report.

28. Auditors should use this technical guidance note when reporting on 2016/17 audits. They should complete for each report the checklist at Appendix 5 which provides a list of the key auditor actions.

2016/17 guidance on statutory objections

29. Audit Strategy has issued module 12 of technical guidance note 2016/10(LA) to provide information and guidance on statutory objections to the unaudited annual accounts. Statutory objections refer to the right of interested persons under section 101 of the *Local Government (Scotland) Act 1973* to inspect and to object to the unaudited annual accounts.

30. Module 12 provides auditors with guidance on dealing with any objections they receive, including cases where a hearing is required. This includes

- considering whether a submission received meets the criteria for being treated as a statutory objection
- the actions required where the submission can be accepted as a valid objection
- the actions required where the submission is not a valid objection.

31. Auditors should refer to this module if they receive a statutory objection to the accounts.

Accounting developments

General accounting

2017/18 accounting code

32. The CIPFA/LASAAC Local Authority Code Board has issued the *Code of practice on local authority accounting in the UK 2017/18* (accounting code) which sets out local authority accounting requirements for 2017/18.

33. The accounting code's financial reporting framework is based on international financial reporting standards (IFRS) as adopted by the European Union, adapted for the local authority context where necessary. The 2017/18 accounting code has been prepared on the basis of accounting standards and other pronouncements in effect for accounting periods commencing on or before 1 January 2017. The changes in this edition of the accounting code that are relevant to Scottish local authorities are summarised in the following paragraphs.

34. Paragraph 3.4.2.87 has been added to require local authorities, when assessing the significance of a particular accounting policy, to consider whether disclosure would assist users in understanding how transactions are reflected in the financial statements. The paragraph advises that it is useful for an authority to disclose

- the choice of policy made by the authority when the accounting code allows different policies
- each significant accounting policy that, while not specifically required by the accounting code, the authority selects and applies to apply to particular transactions or events.

35. Paragraph 3.4.2.23 has been amended to clarify the requirements for going concern reporting. Local authorities that can only be discontinued under statutory prescription are required to prepare their financial statements on a going concern basis of accounting. Transfers of services under local government reorganisation do not negate the presumption that the financial statements should be prepared on that basis. The paragraph clarifies that other bodies that prepare financial statements in accordance with the code that may be discontinued without statutory prescription should follow the going concern reporting requirements in IAS 1.

36. Paragraph 6.5.5.1 has been amended to require pension funds to disclose information on investment management transaction costs, including the amount for each asset class, their nature, and how they arise for different types of investment. This was previously only a recommendation in the 2016/17 code.

37. Auditors should confirm that their local authorities are making the necessary arrangements to ensure they can comply with the new requirements.

Guidance on application of IFRS 9 and IFRS 15 from 2018/19

38. CIPFA has issued *Forthcoming provisions for IFRS 9 and IFRS 15* to set out the provisions to be adopted in the 2018/19 accounting code for *IFRS 9 Financial instruments* and *IFRS 15 Revenue from contracts with customers*.

39. IFRS 9 and IFRS 15 include significant changes to the financial reporting requirements for financial instruments and revenue recognition. The guidance has been issued early to allow local authorities time to make the necessary changes to their financial systems and processes and to assess the financial consequences. Early adoption of these standards is not permitted.

40. The first section of the guidance sets out the changes to the accounting code for IFRS 9, and therefore most of the changes relate to chapter 7 of the accounting code. IFRS 9 replaces *IAS 39 Financial instruments: recognition and measurement*, and includes

- a single classification approach for financial assets driven by cash flow characteristics and how an instrument is managed
- a forward looking ‘expected loss’ model for impairment rather than the ‘incurred loss’ model under IAS 39
- new provisions on hedge accounting.

41. The second section sets out the changes for IFRS 15 and therefore the majority are focused on section 2.7 of the code. IFRS 15 replaces *IAS 18 Revenue* and *IAS 11 Construction contracts* and their associated interpretations. The core principle in IFRS 15 for local authorities is that they should recognise revenue to depict the transfer of promised goods or services to the service recipient or customer in an amount that reflects the consideration to which the authority expects to be entitled in exchange for those goods or services.

42. Each section of the guidance also includes the consequential amendments to the other chapters and sections of the code.

43. Auditors should refer to this guidance when assessing local authority's preparations for complying with the IFRS 9 and IFRS 15 from 2018/19.

Other developments

Housing benefit

Certification of 2016/17 subsidy claims

44. Audit Strategy has published Auditor certification of the 2016/17 housing benefit subsidy claim-technical guidance note TGN/HBS/17 to provide guidance to auditors on certifying 2016/17 housing benefit (HB) subsidy claims.

45. Auditors should follow this technical guidance note when reviewing and reporting on 2016/17 HB subsidy claims.

Changes in size criteria rules

46. The Department for Work and Pensions (DWP) has issued circular 3/2017(Revised) to provide information on the provisions in The Housing Benefit and Universal Credit (Size Criteria) (Miscellaneous Amendments) Regulations 2017 which make changes to the size criteria rules. The changes are necessary in order to comply with the Supreme Court judgment in November 2016 in relation to the judicial review challenges brought against the *Removal of the spare room subsidy* (RSRS) policy.

47. In summary, the regulations allow an extra bedroom for HB claimants when

- a disabled child or disabled non-dependent adult reasonably requires overnight care from a non-resident carer and is in receipt of a specified disability benefit
- a local authority is satisfied that a couple cannot reasonably share a bedroom as a result of a member of the couple's disability and that member is in receipt of a specified disability benefit.

48. The regulations apply in both the private rented sector and social rented sector from 1 April 2017.

Removal of additional ESA

49. The DWP has issued Circular A4/2017 to provide information about The Employment and Support Allowance and Universal Credit (Miscellaneous Amendments and Transitional and Savings Provisions) Regulations 2017.

50. Employment support allowance (ESA) is the main benefit for those people of working age who cannot work because of a health condition or disability. Additional components may be paid to people on ESA in addition to the basic allowance if they are found to have limited capability for work.

51. The regulations remove the additional component for new ESA claims after 3 April 2017.

Limiting HB support to no more than two children

52. The DWP has issued Circular A5/2017 to provide information on The Social Security (Restrictions on Amounts for Children and Qualifying Young Persons) Amendment Regulations 2017 which limit to two the number of personal allowances which can be included in the HB applicable amount in respect of children and young people.

53. The changes came in to force on 6 April 2017.

New disregards from 2017/18

54. The DWP has issued Circular A6/2017 to advise of HB disregards for payments made under the new *Bereavement support payment*.

New right benefit initiative

55. The DWP has issued Circular A7/2017 to announce a new initiative which aims to target key areas of HB fraud and error. The *Right benefit initiative* (RBI) replaces the *Fraud and error reduction incentive scheme* (FERIS) for 2017/18.

56. Funding is being provided by the DWP to local authorities to target claimant 'earnings', the highest area for housing benefit fraud and error. The aim of RBI is to maximise the return on the available investment, target local authority activity on specific areas and remove elements of the previous schemes which were unattractive to local authorities.

57. Local authorities were requested to confirm that they wished to be included in the initiative. All funding is being paid in a single upfront payment (see Circular 6/2017) with no additional incentive payments linked to performance.

2017/18 funding

58. The DWP has issued the following circulars in respect of various types of HB funding:

- S4/2017 (Revised): New burdens funding: Changes to work-related activity group payments in employment and support allowance.
- S5/2017 Removal of temporary accommodation management fee in housing benefit subsidy from 1 April 2017.
- S7/2017 Additional new burdens funding to meet the costs of implementing welfare reform changes in 2017/18.
- S8/2017 Payment of new burdens relating to the Single Fraud Investigation Service project for 2017/18.

Retirement benefits

2016/17 report on actuarial information

59. PricewaterhouseCoopers has prepared a report to provide support to auditors when assessing the actuaries who produce retirement benefits figures under *IAS 19 Employee benefits* as at 31 March 2017.

60. The work carried out for the report involved assessing the competence and objectivity of, and assumptions and approach adopted by, the relevant actuaries. It found that actuaries signing-off the calculation of the figures are appropriately qualified, and the actuarial firms are experienced and well-reputed. There are no known circumstances which would impair their objectivity to produce the figures.

61. The main findings in respect of the assumptions and approach are as follows

- The actuarial assumptions proposed by the actuaries are considered to be reasonable for most employers.
- For some actuaries individual assumptions may fall outside the expected range but when all assumptions are taken together a reasonable liability figure will be produced.
- The report recommends further investigation where an employer has requested different assumptions than those proposed by the actuary.

62. However, there is concern that accurate cash flows and details of significant events may not always be communicated to the actuaries. The report recommends that auditors consider extra tests on the cash flow data provided by employers, and satisfy themselves that any special events that they are aware of have been communicated to the actuaries.

63. Most actuaries follow a process of requesting redundancy and exit data in advance of the year end to allow more time for their calculations and reporting. This approach is reasonable provided there is a procedure to check for significant movements or employer decisions. If auditors are aware of material volumes of redundancies, particularly in the last few months, they should ensure that details of these have been passed onto the relevant actuary.

64. Auditors should use this report in relation to IAS 19 amounts and the work of the actuary in relation to 2016/17.

Grant claims

65. Audit Strategy has issued Certification of 2016/17 approved local authority grant claims and returns - Technical guidance note TGN/GEN/17 to provide general guidance to auditors on the certification of 2016/17 local authority grant claims and returns and to explain the approach and procedures to be adopted. The technical guidance note

- explains the arrangements for the certification of grant claims and other returns
- provides a list of grant claims and other returns which external auditors are required to certify in 2016/17 under their audit appointment
- considers the roles and responsibilities of grant-paying bodies, local authorities, Audit Strategy and appointed auditors
- sets out the overall approach to be adopted by auditors
- provides guidance on auditor reporting.

66. Audit Strategy also separately publishes a technical guidance note on each significant approved claim to provide auditors with specific guidance on certifying that claim. In addition

to Auditor certification of the 2016/17 housing benefit subsidy claim - Technical guidance note TGN/HBS/17 referred to at paragraph 44, the following have been published for 2016/17

- Auditor certification of the 2016/17 Bellwin scheme claims - technical guidance note TGN/BEL/17
- Auditor certification of 2016/17 education maintenance allowances grant claim - technical guidance note TGN/EMA/17
- Auditor certification of 2016/17 criminal justice social work service financial return - technical guidance note TGN/CJS/17
- Auditor certification of 2016/17 non domestic rates income returns - technical guidance note TGN/NDR/17.

67. Auditors should follow these technical guidance notes when reviewing and reporting on 2016/17 grant claims.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action required at paragraph 28 in respect of 2016/17 model independent auditor's reports?			
2 Have you carried out the action required at paragraph 31 in respect of statutory objections to the accounts?			
3 Have you carried out the action recommended at paragraph 37 in respect of statutory objections to the accounts?			
4 Have you carried out the action recommended at paragraph 43 in respect of IFRS 9 and IFRS 15?			
5 Have you carried out the action recommended at paragraph 64 in respect of the report on IAS 19?			

Audit Strategy contacts for local authority chapter

68. The contacts in Audit Strategy for this chapter are

- Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.
- Anne Cairns, Manager - 0131 625 1926 or acairns@audit-scotland.gov.uk (for housing benefit).

Central government chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Strategy on any emerging risks, in the quarter that are relevant to the central government sector.

It should be read by external auditors with appointments in the central government sector. It should also be read by auditors with appointments in the health sector and further education sector as most of the articles also apply to those sectors. Auditors should also read the cross-sectoral chapter.

Accounting developments

Disclosure of new standards not yet effective

69. HM Treasury has issued a guide to new international financial reporting standards (IFRS) that have been issued but are not yet effective in 2016/17, and therefore require disclosure in accordance with *IAS 8 Accounting policies, changes in accounting estimates and errors*.

70. *Review of new IFRS issued and/or effective during 2016/17* clarifies that the standards that have been issued but not effective until 2017/18 include the following

- IFRS 9 Financial instruments
- IFRS 15 Revenue from contracts with customers
- IAS 16 Leases.

71. Auditors should consider this guide when auditing the disclosure of standards issued but not yet effective in the 2016/17 annual report and accounts.

IFRS 9

72. IFRS 9 is replacing IAS 39, and a number of interpretations have been proposed to the 2018/19 FReM in respect of its requirements.

73. The accounting policy choice allowed under IFRS 9 for long term trade receivables, contract assets which do contain a significant financing component, and lease receivables will be withdrawn. This means bodies will always recognise a loss allowance at an amount equal to lifetime expected credit losses. Bodies will be required to utilise the simplified approach to impairment for relevant assets.

74. The accounting policy choice which allows bodies to apply the hedge accounting requirements of IAS 39 will not be available, and bodies will be required to apply IFRS 9.

75. The option to restate prior periods where that is possible without the use of hindsight has been withdrawn. Any difference between the previous carrying amount and the opening carrying amount at the date of initial application will be required to be recognised in the opening retained earnings

76. When considering the disclosures in 2016/17 on standards issued but not yet effective, bodies should be considering

- whether the impact of IFRS 9 is material to the financial statements
- how financial instruments are likely to be classified and measured under IFRS 9
- how the existing disclosures of financial instruments will change.

IFRS 15

77. IFRS 15 recognises revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled to, in exchange for those goods or services.

78. The following interpretations to IFRS 15 have been proposed

- Where revenue that is not classified as a tax but is still received by government through legislation, the contract will be considered to be that legislation.
- Where bodies, with the approval of the Scottish Government, are allowed to keep tax as revenue, it should be accounted for under IFRS 15.
- All bodies are required to restate prior periods in accordance with IAS 8 with the cumulative effect of initially applying IFRS 15 recognised as an adjustment to the opening balance of retained earnings.

79. When considering the disclosures to the financial statements on standards issued but not yet effective, bodies should be considering

- the proportion of its revenue that will be within the scope of IFRS 15 and whether this is material to the financial statements
- whether the body has correctly classified all its income as revenue or tax
- whether applying IFRS 15 will materially change the revenue recognition points
- how the existing disclosures of revenue will change.

IAS 16

80. IFRS 16 removes the distinction between operating and finance leases and introduces a single lessee accounting model. Bodies should be considering

- the operating leases commitments currently held and whether these are material to the financial statements
- the nature of the assets being leased and whether they may be classed as short term or low value leases?

Health chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Strategy on any emerging risks, in the quarter that are relevant to the health sector.

It should be read by external auditors with appointments in the health sector. Auditors should also read the central government sector and cross-sectoral chapter.

Guidance from Audit Strategy on emerging risks

NHS injury cost recovery scheme

81. Audit Strategy has become aware of an emerging risk in respect of the *Injury cost recovery* (ICR) scheme. Under the ICR scheme, the cost of NHS treatment costs can be recovered where personal injury compensation is paid (e.g. after a road traffic accident) primarily from an insurance company or third party compensator.

82. The Department of Health's Guidance on the application of the NHS injury cost recovery scheme for 2016/17 sets out the process to recover costs and how this should be recorded in the financial statements. Day to day operation of the scheme is undertaken by the Cost Recovery Unit (CRU) of the Department of Work and Pensions. The CRU notify boards of claims using form NHS2, which asks for basic treatment details. The form is used to calculate how much is payable, using an average tariff system.

83. Boards will know on completion of the NHS2 details how much they are due to receive when the claim is settled (net of impairment for non-payment equal to 22.94%). They should recognise income and a debtor at the point the form has been received and they have confirmed that treatment has been provided. Initially this should be recognised in long term debtors and transferred to short term debtors after one year. A risk has emerged that not all boards have made the necessary accrual and instead account for recovery on receipt.

84. Auditors should confirm that their boards have properly recognised a debtor at 31 March 2017 for expected recoveries under the scheme.

Auditing developments

Review of central work on CNORIS

85. Audit Strategy has undertaken a review of the work carried out by the NHS Central Legal Office (CLO) relating to the *Clinical negligence and other risks indemnity scheme* (CNORIS). The objective of the review was to establish the extent to which the information prepared using the work of the CLO, as a management expert under *ISA (UK&I) 500 Audit evidence*, can be used as audit evidence.

86. Audit Strategy has also evaluated the appropriateness of the methodology adopted by the Scottish Government to establish the total national liability for CNORIS. The review focused on the estimation of the liability as at 31 March 2017.

87. Audit Strategy has provided auditors with the outcome of the above reviews.

Accounting developments

Performance reports

Good practice note

88. Audit Strategy has issued a good practice note to assist boards in improving the presentation of their performance reports. The note is based on a review of all the territorial health boards' 2015/16 performance reports to identify instances of good practice and areas for improvement.

89. The note sets out some key messages including recommending that boards

- make more use of infographics, charts and graphs
- tailor the disclosure on their purpose and activities to reflect each board's corporate priorities
- ensure that explanations of complex areas are not written in overly technical terms
- use case studies or examples where this can help provide the user with a better insight into performance.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 84 in respect of the NHS cost recovery scheme?			

Audit Strategy contact for health chapter

90. The contact Audit Strategy for this chapter is Neil Cameron, Manager - Central Government and Health (Technical) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.

Fraud and irregularities

Introduction

This chapter contains a summary of fraud cases and other irregularities arising at audited bodies that have recently been reported by auditors to Audit Strategy.

Auditors should consider whether the weaknesses in internal control that facilitated each fraud may apply at their audited bodies and take the appropriate action.

Expenditure

Contract awards

91. Two council employees colluded with contractors resulting in over £10,000 of work to council houses being unfairly or unnecessarily awarded.

Key features

The two employees

- deliberately awarded the majority of work to one painting contractor rather than ensuring the fair allocation to all contractors on the council framework agreement
- instructed unnecessary works to be carried out
- approved payments for works which had not been undertaken.

The fraud was discovered when another contractor in the framework agreement made a complaint about the unfair allocation of works.

The fraud was possible as the supervisor, who was not involved in the collusion, failed to properly monitor the level of variances in the works awarded and failed to identify that additional work was being approved without the necessary authority being given.

Both employees have been suspended and a disciplinary investigation has commenced. The supervisor has been suspended due to their poor performance.

Changes have been made within the building maintenance depot to ensure policies and procedures are being followed and the allocation of works to contractors is fair.

Social care overpayments

92. A council continued to pay over £5,000 to a residential care home after the death of the resident.

Key features

The council's system was reliant on care homes submitting a weekly return which included notification of changes to service users' circumstances. The council's internal control failed to identify that the care home in question had not submitted a return for the week in which the resident died.

The overpayment was identified under the *National fraud initiative* when a data match between private residential care home and deceased person records highlighted that the payments to the care home were continuing after the resident had died.

All amounts overpaid have since been recovered.

Checks are now in place to ensure all care home returns are received each week.

Change of bank details

93. A third party attempted to defraud £2.35 million from a council by redirecting payments for a legitimate supplier.

Key features

The fraudster sent a forged letter to the council purporting to be from the supplier requesting a change in bank details. The council updated the bank details, and made two payments to the new bank account.

The fraud was discovered when the bank subsequently rejected the BACS payments and returned the money to the council.

The fraud was possible as officers did not confirm the amended bank details with the supplier.

Income

Cash misappropriation

94. A clerical assistant in a council education service embezzled over £5,000 over an eight month period.

Key features

The perpetrator carried out the fraud both by failing to bank cash income and withdrawing cash to pay for authorised services but not making the payments.

The fraud was possible due to a lack of segregation of duties, and poor financial monitoring and physical cash controls.

The fraud was discovered when a supplier queried why transport costs were not paid as expected. This prompted an investigation by internal audit.

The employee was dismissed and reported to the police.

False refunds

95. An officer defrauded almost £11,000 from a council by creating false refunds for personal gain.

Key features

The officer fraudulently processed electronic and cash refunds over a four year period.

The fraud was possible due to inadequate access controls to the cash receipting system which allowed staff to use the log in details of colleagues. It was not possible to identify which member of staff had processed a particular refund.

The fraud was identified after management identified a suspicious transaction and referred the matter to the council's counter fraud service. On being interviewed the employee admitted to the thefts. Disciplinary action was taken against the employee who was also convicted and sentenced to four months imprisonment. Some of the amount defrauded as been recovered from the employee's final pay and efforts are ongoing to recover the balance owed from the employee's pension.

Reporting procedures have been enhanced and detailed transaction reports are now produced which will immediately highlight any discrepancies. Proper system login processes have been implemented, and employee logins are now monitored.

Banking error

96. The head of an education centre paid incorrectly £6,000 of council cash into the bank account of a third party.

Key features

The employee paid childcare payments received from a debtor into the bank account of a parent rather than to the council’s bank account. The issue was highlighted when the council team pursued the apparent non-payment of the debt with the debtor.

An internal audit investigation concluded that the employee had behaved carelessly rather than fraudulently, but nevertheless recommended disciplinary action. A process has been put in place to ensure debts relating to these services are pursued more quickly.

The council has been unable to recover the money to date and the matter has been referred to the police.

Payroll

Manipulation of staff incentive scheme

97. An employee obtained £13,000 by manipulating a staff incentive scheme.

Key features

The employee manually amended the records used for the processing of payroll in relation to the staff incentive scheme to secure payments to which they were not entitled.

The fraud was possible due to a lack of segregation of duties and limited challenge of payment requests. It was identified after an acquaintance of the employee reported concerns to the Head of HR.

Internal control has been improved so that

- dual sign off is now required for payments under the incentive scheme
- payment processing now falls within the remit of the Finance Team supported by a direct reconciliation to system reports
- payment approval is now under the control of the Finance Director.

The employee has been dismissed following a disciplinary hearing, and the matter was reported to Police Scotland.

Equipment and stores

Theft

98. A council building services employee stole plant, equipment and fuel valued at over £87,000 over a nine month period.

Key features

The theft was possible due to weaknesses in stock control, physical security and segregation of duties. It was identified after management received an anonymous tip-off.

The matter was reported to Police Scotland who searched the employee's home address and home storage units and recovered £87,300 worth of plant and equipment.

Following disciplinary action, the employee resigned.

New stock control and fuel issuing processes have been implemented, spot checks are being undertaken, and segregation of duties has been improved.

Cybercrime-malware

99. A third party attempted to misappropriate over £120,000 from a body's bank account by using malware to access the account remotely.

Key features

> The perpetrator infected with malware a computer used by the finance team in order to gain access to the body's online bank accounts. This resulted in the transfer over £85,000 internally and an attempted transfer of an additional £35,000 externally.
>
> The fraud was identified as the attempted transfer triggered the banks counter-fraud controls.
>
> The malware attack was possible as anti-virus software recommended by the bank had not been installed on the computer in question as the employee who used it did not make payments.
>
> The relevant anti-virus software has now been installed on all computers where staff have any access rights to the online bank account. There has also been a general increased awareness within the finance team of the potential for malware attacks.
>
> The police have been informed.

Audit Strategy contact for fraud and irregularities chapter

100. The contact in Audit Strategy for this chapter is Anne Cairns, Manager - 0131 625 1926 or acairns@audit-scotland.gov.uk.

Audit Strategy

Audit Scotland's Audit Strategy business group informs the professional judgement of appointed external auditors on technical matters and encourages the proper exercise of professional scepticism to improve the quality of the audit delivered to the Accounts Commission and Auditor General for Scotland. Audit Strategy provides authoritative guidance and practical assistance to support appointed auditors in carrying out their responsibilities under the *Code of audit practice* to

- provide an opinion on audited bodies' financial statements and, where required, the regularity of transactions
- review and report on other information published with the financial statements, including governance statements and remuneration reports
- examine and report on approved grant claims and other returns submitted by local authorities
- review and report on whole of government accounts returns.

Contact details for relevant Audit Strategy staff are included at the end of each chapter.

Feedback on technical bulletins is encouraged and should be sent to

pobrien@audit-scotland.gov.uk

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Technical bulletin 2017/3

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AUDIT SCOTLAND

Prepared by Audit Strategy

12 September 2017

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Foreword

Technical bulletins are prepared by Audit Scotland's Audit Strategy business group, and approved by the Assistant Auditor General, to provide external auditors appointed by the Accounts Commission and Auditor General for Scotland with

- information on the main public sector technical developments in the quarter that are relevant to their audit appointment
- guidance from Audit Strategy on any emerging risks identified in the quarter.

Technical bulletins are available to external auditors from Audit Scotland's *Technical reference library,* and published on the Audit Scotland website so that audited bodies and other stakeholders can access them.

It is important that auditors read this technical bulletin promptly so they are familiar with the information and guidance provided. The auditor action checklist section at the end of each chapter should be completed by a senior member of the audit team.

The articles on technical developments are intended to highlight the key points that Audit Strategy considers external auditors require to be aware of. It may still be necessary for auditors to read the source material where greater detail is required. The documents referred to in the articles can be obtained by using the hyperlinks, where available. They are also available to external auditors from Audit Scotland's *Technical reference library*.

While auditors act independently, and are responsible for their own conclusions and opinions, Audit Strategy has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement. Consistency in similar circumstances is important and paragraph 108 of **Audit Scotland's *Code of audit practice* therefore states that auditors should normally follow Audit Strategy guidance.** This means that auditors are expected to follow the guidance or provide a reasonable explanation as to why not. Auditors should advise Audit Strategy promptly if they intend not to follow guidance provided in this technical bulletin on an emerging risk.

Audit Strategy encourages feedback on this technical bulletin. Comments should be sent to pobrien@audit-scotland.gov.uk.

More in-depth and extensive guidance is provided in separate technical guidance notes published by Audit Strategy. Technical guidance notes published in the quarter are referred to in this technical bulletin, and can be obtained by using the hyperlinks to the Audit Scotland website.

Headlines

This chapter provides brief headlines for the articles on technical developments and guidance in this technical bulletin, classified by the audit year to which it relates, and referenced to the paragraphs containing the main article.

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Cross-sectoral chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Strategy on any emerging risks, in the quarter that are relevant to all sectors.

It should be read by all external auditors. Information on developments and guidance from Audit Strategy in the quarter that are relevant to only one sector are covered in the relevant sector-specific chapter.

Auditing developments

Revised guidance on bank confirmations

1. The Financial Reporting Council (FRC) has decided to withdraw practice note 16 on bank confirmations and replace it with limited amendments to the following two auditing standards
   - ISA (UK) 330 The auditors response to assessed risks has been amended to add application material in respect of bank confirmation letters. It states that, depending on their risk assessment, auditors should consider whether confirmation is needed in relation to additional information (e.g. information about guarantees), as well as balances and other banking arrangements. The amendments are intended to encourage auditors to apply their professional judgement as to when a confirmation report is required.
   - A footnote has been added to ISA (UK) 500 External confirmations to advise that templates that can be used to obtain bank confirmations are available from the British Bankers' Association website.
2. The changes will be effective for audits of periods commencing on or after 15 December 2017, although early adoption permitted.

Revised standard on laws and regulations

3. The FRC has issued a revised version of ISA (UK) 250 Section A Consideration of laws and regulations effective for audits for periods commencing on or after 15 December 2017.
4. The revisions, which are limited in scope, reflect changes made to the international code of ethics which provide a framework to support reporting by accountants where they identify non-compliance with laws or regulations in the course of their work. The International Auditing and Assurance Standards Board (IAASB) has made minor changes to align ISA 250 with the requirements of the revised ethics code.
5. The changes made by the FRC help to improve the clarity of the ISA (UK), e.g. the definition of non-compliance has been amended to cover a broader range of instances that are contrary to the prevailing laws or regulations. This is supported by application material on laws and

regulations that deal with fraud, corruption and bribery and money laundering, terrorist financing and proceeds of crime.

New report on professional scepticism

6. The IAASB has issued Toward enhanced professional scepticism which is aimed at enhancing the exercise of professional scepticism when carrying out an audit.

7. Key observations in the report include
   - Strong business acumen (e.g. a sufficient knowledge of the audited body's business model) and professional competencies, in addition to a sufficient understanding of relevant standards and legislation, enable robust professional scepticism.
   - Professional scepticism can be impeded by tight financial reporting deadlines, resource constraints, a firm's tone at the top, incentive systems, local culture and a range of cognitive biases. Heightening awareness of these and other factors is the first step to mitigate their impact.
   - Personal traits play a role in the exercise of professional scepticism (e.g. confidence; an inquisitive nature; an individual's response to stress, time pressures, or conflict; knowledge; practical experience; and cultural background. In consideration of these factors, standards might be improved by including more guidance about how an awareness and understanding of personal traits and biases can enhance the exercise of professional scepticism.
   - Education and training can raise awareness and develop the needed attitude. It is critical to reinforce and monitor the application of professional scepticism, including through setting the right tone at the top.

Other developments

Financial management

Guidance on balance sheet management

8. The Chartered Institute of Public Finance and Accountancy (CIPFA) has published Balance sheet management in the public services to help public bodies better understand their balance sheets, as well as the issues and challenges associated with managing them effectively.

9. The publication explains that the objective of balance sheet management in the public services is to support service delivery. A body that manages its assets and liabilities well is better placed to deliver effective financial management and robust accounting and financial reporting.

10. It therefore defines balance sheet management as the active assessment and management of all the organisational, operational and financial activities and transactions that determine or influence balance sheet values to promote effective stewardship of public money and value for money in use of resources.

11. This definition goes beyond balance sheet values in isolation to reflect the operational and financial activities that ultimately lead to those values. It presents a framework for analysing the wide range of functions and activities that have balance sheet management implications, and for assessing a body's performance against benchmarks of good practice. This assessment is conducted across the categories of

- governance, risk and controls
- accounting and external reporting
- financial management and decision-making
- operational management.

12. The publication covers the following

- Chapter 2 introduces the types of issue that need to be considered in the context of public sector balance sheets.
- Chapter 3 introduces an approach whereby public sector bodies can self-assess their current practices related to balance sheet management and identify and implement improvements.
- Chapter 4 includes an analysis tool to help understand more about the nature and characteristics of the body's balance sheet, highlighting areas of particular financial or operational significance. It also includes a detailed self-assessment tool to compare current balance sheet practices against good practice.

Proposed changes to treasury management code

13. CIPFA has issued a consultation paper that proposes changes to the *Treasury management in the public services: Code of practice and cross-sectoral guidance notes* from 2018/19. The proposals are based on the comments offered in response to the initial request for views in April 2017.

14. The treasury management code provides a framework for effective treasury management in public sector organisations. It defines treasury management as

- the management of a body's investments and cash flows, banking, money market and capital market transactions
- the effective control of the risks associated with those activities
- the pursuit of optimum performance consistent with those risks.

15. The consultation paper proposes to

- change the indicator on principal invested for longer than 364 days to principal invested over 365 days in line with financial reporting definitions
- remove the interest rate exposure indictor and require the treasury management strategy to state how interest rate exposure is managed and monitored
- extend the indicator on maturity structure of borrowing to cover variable as well as fixed rate debt

- clarify that the code covers all investments held primarily for financial returns, and that this may include some service investments. The annex to the consultation document contains an extract of the substantive changes proposed to the code
- allow some reporting of detailed indicators and monitoring information to a committee or sub-committee whilst making clear that responsibility remains with the board/full council. The key changes are set out in the annex.

16. Responses should be submitted to matthew.allen@cipfa.org by 30 September 2017.

Audit Strategy contact for cross-sector chapter

17. The contact in Audit Strategy for this chapter is Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Local authority sector

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Strategy on any emerging risks, in the quarter that are relevant to the local authority sector.

It should be read by external auditors with appointments in the local authority sector. Auditors should also read the cross-sectoral chapter.

Accounting developments

General accounting

Consultation on 2018/19 accounting code

18. The CIPFA/LASAAC Local Authority Code Board has issued a consultation paper with proposed amendments to the 2018/19 *Code of practice on local authority accounting in the UK* (the draft code). It comprises an invitation to comment as well as extracts from the draft code with the proposed amendments set out.

19. The consultation paper
    - sets out areas for consideration on the approach to adopting *IFRS 9 Financial instruments*
    - seeks views on the approach to the disclosure framework under *IFRS 15 Revenue from contracts with customers*
    - proposes changes as a result of narrow scope amendments to international financial reporting standards (IFRS)
    - proposes amendments to debtors and creditors disclosures
    - includes initial issues concerning the application of *IFRS 16 Leases* from 2019/20.

20. Responses should be submitted to code.responses@cipfa.org by 6 October 2017.

Adoption of IFRS 9

21. CIPFA/LASAAC consulted on the approach to the adoption of IFRS 9 last year, and then issued a publication setting out the agreed position. The publication was issued with the 2017/18 Code in order to provide local authorities with time to prepare for the changes. However, CIPFA/LASAAC considers further clarification might be needed in the following two areas
    - Purchased or originated credit-impaired financial assets.
    - Simplified approach for trade receivables, contract assets and lease receivables.

Purchased or originated credit-impaired financial assets

22. IFRS 9 replaces the incurred loss model under IAS 39 with the expected loss model which is intended to provide more useful information about a body's expected credit losses on financial instruments. The guiding principle for the model is that it requires an authority to recognise expected credit losses at all times and to update the amount of expected credit losses recognised at each reporting date to reflect changes in the credit risk of financial instruments. CIPFA/LASAAC has agreed to adopt the provisions on the expected credit loss impairment model without adaptation or interpretation. The approach has been to focus in the code on those provisions in IFRS 9 most likely to apply to local authorities.

23. IFRS 9 defines a financial asset as credit impaired when events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. CIPFA/LASAAC's view has been that it was unlikely that local authorities would have purchased or originated credit-impaired financial assets (but where these did occur the IFRS 9 would need to be followed). However, a respondent to last year's consultation indicated that some housing rent debtors may be considered to be credit impaired on acquisition. CIPFA/LASAAC are seeking views on whether this is a material and frequent transaction for local authorities. If so, it is proposed that the relevant paragraph of IFRS 9 will be added to the code.

Simplified approach for trade receivables, contract assets and lease receivables

24. IFRS 9 provides a simplified approach which requires recognition of a loss allowance based on lifetime expected losses from origination. Under the code, a local authority
    - will be required to apply the simplified approach for trade receivables or contract assets that result from transactions within the scope of IFRS 15 that do not contain a significant financing component
    - has a policy choice to apply either the simplified approach or the general approach where there is a significant financing component and for lease receivables. However, the *Government financial reporting manual* (the FReM) is expected to require central government bodies to apply the simplified approach to the transactions.

25. CIPFA/LASAAC notes the advantages of consistency across the public sector and the benefits of reducing the reporting burden but is concerned that the FREM's approach may result in a more significant 'day one' loss for local authorities. It is not, therefore, proposing to change the code's approach but would welcome any comments on the impact of a change.

IFRS 15

26. CIPFA/LASAAC also consulted on the approach to the adoption of IFRS 15 last year, and set out the approach in the same publication covering IFRS 9.

27. The disclosures under IFRS 15 are substantially more detailed than currently required. It requires disclosures to help users understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. However, CIPFA/LASAAC is of the view that local authority income transactions are not normally complex and do not

normally involve substantial recognition or measurement issues. It therefore considered that local authorities should only include the IFRS 15 disclosures if the information relating to the disclosure is material to its financial statements and therefore the approach in the separate publication is to require direct reference to IFRS 15 when this is the case.

28. However, the consultation paper seeks views on alternative approaches including having the code specify the disclosure requirements.

Narrow scope amendments to IFRS

29. The proposals in the consultation paper arising from narrow scope amendments to IFRS include

- amendments in respect of *IAS 7 Statement of cash flows (Disclosure initiative)* which will require local authorities to provide disclosures that enable users of the financial statements to evaluate changes in liabilities arising from financing activities
- amendments to *IAS 12 Income taxes (Recognition of deferred tax assets for unrealised losses)* which clarify how to account for deferred tax assets related to debt instruments measured at fair value (these may apply in practice to the group accounts)
- an amendment to *IAS 40 Investment property (Transfers of investment property)* which provides clarification on transfers to or from the investment property classification
- various minor changes from the *Annual improvements to IFRS standards 2014 – 2016 cycle* (outlined in Appendix B to the exposure draft)
- *IFRIC 22 Foreign currency transactions and advance consideration* which sets out the exchange rate to use in reporting foreign currency transactions when payment is made or received in advance.

Proposed amendments to debtors and creditors disclosures

30. The 2017/18 code requires disclosure of an analysis of debtors and creditors across specified groupings of public sector organisations. The equivalent disclosures have been removed from the FReM and therefore CIPFA/LASAAC is proposing to remove them from the code.

Application of IFRS 16

31. Subject to CIPFA/LASAAC's decisions on adoption, IFRS 16 will apply to the 2019/20 code. IFRS 16 specifies the principles for accounting for leases both for the lessee and for the lessor.

32. IFRS 16 introduces a single lessee accounting model whereby all leases (with some exceptions) will be accounted for in a similar way to the current IAS 17 treatment for finance leases. IFRS 16 requires a lessee to recognise

- assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value
- a right-of-use asset representing its right to use the underlying leased asset
- a liability representing its obligation to make lease payments.

33. CIPFA/LASAAC has established a sub group on leases to consider the approach to applying IFRS 16 and to assist in preparing a further consultation paper for adoption in the Code planned for December 2017.

34. Appendix C to this consultation paper provides a brief outline of IFRS 16 and includes initial issues regarding its application to local authorities including whether

- the code should include specific provisions on the application on the low value exemption for local authority circumstances
- the short-term exemption should be mandated by means of an adaptation in the code
- authorities will be able to measure the lease liability by using the interest rate implicit in the lease or whether they will need to use the incremental borrowing rate and, if so, the practicalities of identifying this rate across an authority's portfolio of leased assets
- the code should require that the subsequent measurement of the right-of-use asset is to be at current value, where material
- on transition, there should be full retrospective restatement (i.e. restating preceding year information) or a cumulative catch-up retrospective approach (i.e. adjusting the opening balance of reserves).

2017/18 disclosure checklist

35. CIPFA has issued the disclosure checklist for the 2017/18 annual accounts. The checklist identifies the requirements of the accounting code.

36. When checking that the Code's disclosure requirements have been met in the 2017/18 accounts, auditors should

- request that the authority completes the 2017/18 disclosure checklist
- investigate the reasons for any non-compliance that that the checklist highlights.

Other developments

Housing benefit

Certification of 2016/17 subsidy claims

37. Public Sector Audit Appointments (PSAA) has issued the following modules of the 2016/17 HB COUNT approach to the certification of housing benefit subsidy claims

- Module 4 is the analytical review tool component. It provides a number of useful worksheets including the following two which require to be completed
  - The year-to-year worksheet where 2015/16 claim data is entered manually for comparison against 2016/17 data.
  - The key ratios worksheet that allows comparison with other authorities.
- Module 5 is the software diagnostic tool. The module contains a control matrix that requires to be completed by auditors when certifying 2016/17 HB subsidy claims.

2017/18 funding

38. The Department for Work Pensions (DWP) has issued the following circulars in respect of various types of HB funding

- S9/2017 Initial payment for real time information bulk data matching initiative 2017/18
- S11/2017 Additional new burdens payments for 2017/18.

Prudential framework

Proposed changes to prudential code

39. CIPFA has issued a consultation paper that proposes changes to the *Prudential code for capital finance in local authorities* from 2018/19. The proposals are based on the initial request for views in April 2017.

40. There is a proposal that the code objective that treasury management decisions are taken in accordance with good professional practice be deleted and the requirement to adopt CIPFA's treasury management code is removed.

41. There is also a proposal to introduce a requirement to report on the overall capital strategy to full council. It is proposed that

- the capital strategy should demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability
- the strategy should set out the long term context in which capital expenditure and investment decisions are made and give due consideration to both risk and reward and impact on the achievement of priority outcomes
- a principles based approach is taken, highlighting key areas to be covered. The proposed wording is contained within the annex to the paper
- the Chief Finance Officer should report explicitly on the deliverability, affordability and risk associated with the capital strategy.

42. Responses should be submitted to matthew.allen@cipfa.org by 30 September 2017.

Whole of government accounts

2016/17 guidance

43. HM Treasury has issued guidance on completing the 2016/17 returns for whole of government accounts (WGA). External auditors are required to review the returns for bodies above a prescribed threshold and report the results of their review to the National Audit Office (NAO) in an assurance statement.

44. The prescribed threshold for 2016/17 is where either gross assets (excluding property, plant and equipment, heritage assets, intangibles, investment properties, and assets held for sale), or gross liabilities (excluding pension liabilities), or gross income or gross expenditure is above £350 million.

45. Audit Strategy has issued Technical guidance note 2017/9(LA) to provide guidance for auditors on reviewing and reporting on the 2016/17 WGA returns of local authorities above the threshold. The approach set out in the technical guidance note has been agreed with the NAO.

46. The changes in the content of the technical guidance note compared with 2015/16 are as follows

- Re-ordering and minor re-wording of certain tests.
- A new requirement for the ISA 260 report (or annual audit report where combined) to be submitted to the NAO.
- Auditors are no longer required to submit a scanned version of the assurance statement and unadjusted errors schedule.

Equal pay

Accounts Commission report

47. The Accounts Commission has published a report on Equal pay in Scottish councils. Key messages include

- Councils have made £232 million of compensation payments to 50,000 workers who had historically been unfairly paid. Exhibit 2 shows an analysis of the 29 councils which provided data.
- Between 2004/05 and September 2016, around 70,000 equal pay claims have been lodged against councils. Exhibit 3 shows the number of claims each year and exhibit 4 analyses the total number over each council.
- The cost of compensation agreements and settling claims, along with legal fees, amounts to around £750 million. Exhibit 5 analyses this total over each council.
- There are almost 27,000 live equal pay claims. Exhibit 7 shows the number of 'live' claims as a percentage of all claims lodged against each council.

Audit Strategy contacts for local authority chapter

48. The contacts in Audit Strategy for this chapter are

- Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.
- Anne Cairns, Manager - 0131 625 1926 or acairns@audit-scotland.gov.uk (for housing benefit).

Central government chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Strategy on any emerging risks, in the quarter that are relevant to the central government sector.

It should be read by external auditors with appointments in the central government sector. It should also be read by auditors with appointments in the health sector and further education sector as most of the articles also apply to those sectors. Auditors should also read the cross-sectoral chapter.

General developments

Finance guidance notes

Changes to SPFM

49. The Scottish Government Financial Management Directorate announced amendments to the following sections of the Scottish public finance manual in finance guidance note 2017/6

- Accountability
- Annual accounts
- Tax planning and tax avoidance.

50. The section on annual accounts has been amended to emphasise that

- a public body's board has a role in approving the body's annual accounts and ensuring that the Minister is provided with the annual report and accounts to be laid before the Scottish Parliament
- the Chief Executive as the Accountable Officer of the public body is responsible for signing the accounts and ultimately responsible to the Scottish Parliament for their actions.

Whole of government accounts

2016/17 guidance

51. HM Treasury has issued guidance on completing the 2016/17 returns for whole of government accounts (WGA). External auditors are required to review the returns for bodies above a prescribed threshold and report the results of their review to the National Audit Office (NAO) in an assurance statement.

52. The prescribed threshold for 2016/17 is where either gross assets (excluding property, plant and equipment, heritage assets, intangibles, investment properties, and assets held for sale),

or gross liabilities (excluding pension liabilities), or gross income or gross expenditure is above £350 million.

53. Audit Strategy has issued Technical guidance note 2017/8(CG) to provide guidance for auditors on reviewing and reporting on the 2016/17 WGA returns of central government bodies above the threshold. The approach set out in the technical guidance note has been agreed with the NAO.

54. The changes in the content of the technical guidance note compared with 2015/16 are as follows

- Re-ordering and minor re-wording of certain tests.
- A new requirement for the ISA 260 report (or annual audit report where combined) to be submitted to the NAO.
- Auditors are no longer required to submit a scanned version of the assurance statement and unadjusted errors schedule.

Audit Strategy contact for central government chapter

55. The contact Audit Strategy for this chapter is Neil Cameron, Manager - Central Government and Health (Technical) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.

Health chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Strategy on any emerging risks, in the quarter that are relevant to the health sector.

It should be read by external auditors with appointments in the health sector. Auditors should also read the central government sector and cross-sectoral chapter.

Auditing developments

NHS workforce planning report

56. Audit Scotland has issued NHS workforce planning which is the first in a two-part audit on the NHS workforce. It focuses on the overall planning arrangements looking at how well placed the NHS workforce is to meet the current and future demands of the Scottish population. The key messages include

- Between 2011/12 and 2016/17, spending on NHS staff increased by 11%.
- Most NHS territorial boards overspent against their pay budget in 2016/17, with agency staff costs increasing in real terms by 107% in six years.
- There are urgent workforce challenges facing the NHS and improving workforce planning is critical to addressing these pressures.

Audit Strategy contact for health chapter

57. The contact Audit Strategy for this chapter is Neil Cameron, Manager - Central Government and Health (Technical) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.

Further education chapter

Introduction

This chapter contains information on the main technical developments in the quarter that are relevant to the further education sector.

It should be read by external auditors with appointments in the further education sector. Auditors should also read the central government sector and cross-sectoral chapter.

Auditing developments

Technical guidance notes

Audit of 2016/17 annual report and accounts

58. Audit Strategy has published Audit of 2016/17 annual report and accounts (further education) - technical guidance note 2017/6(FE) to provide auditors with guidance on performing the audit of the 2016/17 further education annual report and accounts.

59. The technical guidance note comprises

- an overview module including the financial reporting framework, key auditing standards, and presentation of financial statements
- modules 1 to 4 on financial statement areas, e.g. tangible fixed assets, retirement benefits
- module 5 on the regularity of expenditure and income
- module 6 on the performance report, governance statement, and remuneration and staff report. This module has been updated to provide guidance on the new opinions referred to later at paragraph 65

60. The modules highlight the main risks of misstatement in each area, explain the correct treatment, and set out actions for auditors to assess whether the body has followed the required treatment. Following extensive consultation with all auditors, the technical guidance note represents an agreed position on a range of complex technical issues and is a key document as auditors plan and perform the audit of colleges' 2016/17 annual report and accounts.

61. For the purposes of the Audit Scotland website, all the modules have been combined into one document. The individual modules are also available from the relevant subject pages on the further education site of the *Technical reference library*. There is also a module containing a summary of the risks of misstatement available as a word document which auditors may use to satisfy themselves that their audit programmes adequately address the highlighted risks.

62. While auditors are responsible for their own conclusions and opinions, consistency in similar circumstances is important. Auditors should read the technical guidance note so they are familiar with the guidance provided. It is important that auditors follow the actions set out, subject to local judgements on materiality, to ensure that all auditors adopt a consistent approach to common risks.

63. Auditors should use the technical guidance note when performing the audit of the 2016/17 further education annual report and accounts.

2016/17 model independent auditor's reports

64. Audit Strategy has issued 2016/17 Independent auditor's report (further education) - technical guidance note 2017/7(FE) to provide auditors with the model independent auditor's reports which should be used for the 2016/17 annual report and accounts. The technical guidance note also provides application guidance on their use.

65. In the interests of consistency, auditors are required to use the relevant model report in the appendices to the technical guidance note as a condition of their audit appointment. The only exception is any amendments required to tailor the terminology to reflect local circumstances.

66. The model independent auditor's reports for 2016/17 have been amended to

- comply with the new ISA (UK) 700, which contains a revised structure for the independent auditor's report
- include new opinions in respect of whether the performance report and governance statement have been prepared in accordance with the accounts direction.

67. Any proposed modifications to any audit opinion or conclusion in the model reports, or the inclusion of 'emphasis of matter' or 'other matter' paragraphs, should be discussed with Audit Strategy in advance of finalising the report.

68. Auditors should use this technical guidance note when reporting on the audit of the 2016/17 annual reports and accounts. They should complete the checklist at Appendix 3 which provides a list of the key auditor actions.

Reports on sector

2015/16 overview

69. The Auditor General for Scotland has issued Scotland's colleges 2017 to provide an overview the college sector in Scotland.

70. The report states that Scotland's college sector remains financially stable but faces financial challenges as the underlying deficit has increased and colleges hold less cash than in the previous year.

Accounting developments

General accounting

2016/17 accounts direction

71. The Scottish Funding Council (SFC) has issued their accounts direction for colleges for 2016/17. The direction requires colleges to comply with the 2015 Statement of recommended practice: Accounting for further and higher education (the 2015 SORP) in preparing their financial statements.

72. Specific mandatory disclosure requirements for colleges are set out at Appendix 2. Colleges are required to include a performance report and accountability report in their annual report and accounts in accordance with the 2016/17 Government financial reporting manual. The main changes in the 2016/17 accounts direction are summarised in the following paragraphs.

73. The requirements for the performance report have been amended to require
    - a short explanation of the purpose of the overview section
    - an analysis of how the cash budget allocation previously earmarked for depreciation was spent. This is referred to as the 'cash budget for priorities' in the direction and the analysis should take the form of a table showing the expenditure under each heading and the impact on the operating position. An illustrative form of wording is provides at Appendix 5 of the accounts direction
    - details of the underlying operating position. A template for calculating the underlying operating position is provided at Appendix 7 of the accounts direction.

74. The requirement to disclose expenditure on consultancy and off payroll arrangements in the remuneration and staff report has been removed.

75. There is a new requirement to include a statement at the foot of the statement of comprehensive income that explains that the SORP does not permit non-cash allocations for depreciation to be recognised as income in the statement of comprehensive income. A new note is required which provides further explanation and sets out the operating position adjusted for the non-cash allocation for depreciation. An illustrative form of words is provided at paragraph 1 of Appendix 6 to the accounts direction.

76. In preparing their governance statement colleges are required to give due regard to the guidance contained in Appendix 3 and the specific requirements of the Scottish public finance manual.

Guidance on 2016/17 financial statements

77. The SFC has issued Detailed notes for guidance on completion of the 2016/17 financial statements which are designed to supplement the accounts direction for 2016/17. The guidance covers key disclosures in the financial statements, including model disclosure notes set out at Annexes A to E.

78. There have been no significant changes in the guidance notes from 2015/16.

Provisions and contingencies

Guidance for early retirement provision

79. The SFC has issued Guidance for early retirement provision spreadsheet completion to advise that the suggested net interest rate for early retirement pension calculations in 2016/17 has been changed to 0.00%.

80. Auditors should confirm their colleges have used an appropriate discount rate when calculating their early retirement provision, and have paid due regard to the rate suggested by the SFC.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you used the technical guidance note referred to at paragraph 62 when performing the audit of the 2016/17 further education annual report and accounts?			
2 Have you used the technical guidance note referred to at paragraph 67 when reporting on the audit of the 2016/17 further education annual report and accounts?			
3 Have you carried out the action recommended at paragraph 79 in respect of the early retirement provision?			

Audit Strategy contacts for further education chapter

81. The contacts in Audit Strategy for this chapter are

- Neil Cameron, Manager - Central Government and Health (Technical) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.
- Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or hcobb@audit-scotland.gov.uk.

Fraud and irregularities

Introduction

This chapter contains a summary of fraud cases and other irregularities arising at audited bodies that have recently been reported by auditors to Audit Strategy.

Auditors should consider whether the weaknesses in internal control that facilitated each fraud may apply at their audited bodies and take the appropriate action.

Expenditure

Invalid funding application

82. An unknown third party defrauded £38,000 from a non-departmental corporate body by submitting false applications for funding available to small businesses to be used for training.

Key features

The fraud was possible due to a lack of segregation of duties and weaknesses in the documentation of due diligence checks on funding claims. The fraud was identified by an employee who noticed similarities between different claims.

Internal audit carried out a 100% check on the claims and made recommendations to improve the controls in place including the need for

- the documentation of due diligence checks
- supporting evidence for all claims to be maintained
- process maps and operating procedures to be updated, with training to be provided
- updating the fraud policy.

Consideration is also being given to reviewing expenditure controls in other similar funding schemes.

Fraudulent cheque

83. A third party defrauded £17,500 from a council by presenting a fraudulent cheque for payment through the automated banking system.

Key features

A council employee identified that a cheque had been debited to the council's bank account, which the council had not issued.

After contacting the back it was identified that the cheque was forged. The unusual element was that the forged cheque was sophisticated enough to be machine readable and was able to be processed automatically.

The bank agreed to credit the bank account resulting in no financial loss to the council.

The matter has been reported to the bank’s fraud section and Police Scotland.

Audit Strategy contact for fraud and irregularities chapter

84. The contact in Audit Strategy for this chapter is Anne Cairns, Manager - 0131 625 1926 or acairns@audit-scotland.gov.uk.

Audit Strategy

Audit Scotland's Audit Strategy business group informs the professional judgement of appointed external auditors on technical matters and encourages the proper exercise of professional scepticism to improve the quality of the audit delivered to the Accounts Commission and Auditor General for Scotland. Audit Strategy provides authoritative guidance and practical assistance to support appointed auditors in carrying out their responsibilities under the *Code of audit practice* to

- provide an opinion on audited bodies' financial statements and, where required, the regularity of transactions
- review and report on other information published with the financial statements, including governance statements and remuneration reports
- examine and report on approved grant claims and other returns submitted by local authorities
- review and report on whole of government accounts returns.

Contact details for relevant Audit Strategy staff are included at the end of each chapter.

Feedback on technical bulletins is encouraged and should be sent to

pobrien@audit-scotland.gov.uk

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Technical bulletin 2017/4

October to December 2017

AUDIT SCOTLAND

Prepared for appointed auditors in all sectors

11 December 2017

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Foreword

Extracts from the code of audit practice

Technical support

40. Auditors appointed by the Auditor General for Scotland or the Accounts Commission are responsible for giving an opinion on the financial statements and reporting on other related matters. Audit Scotland provides technical support to appointed auditors in respect of these responsibilities to inform their professional judgement.

108. Audit Scotland provides technical support and guidance to all appointed auditors. While appointed auditors act independently, and are responsible for their own conclusions and opinions, Audit Scotland has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement.

An element of the technical support and guidance to appointed auditors referred to in the above extracts from the Code of audit practice is technical bulletins provided by Audit Scotland's Professional Support.

The purpose of technical bulletins is to provide appointed auditors with

- information on the main public sector technical developments in the quarter that are relevant to their audit appointment
- guidance from Professional Support on any emerging risks identified in the quarter.

This technical bulletin applies to appointed auditors in all sectors, though some sections apply to a particular sector.

Technical bulletins are available to appointed auditors from Audit Scotland's *Technical reference library,* and published on the Audit Scotland website so that audited bodies and other stakeholders can access them.

The articles on technical developments are intended to highlight the key points that Audit Scotland's Professional Support considers appointed auditors require to be aware of. It may still be necessary for auditors to read the source material if greater detail is required. The documents referred to in the articles can be obtained by using the hyperlinks, where available. They are also available to external auditors from Audit Scotland's *Technical reference library*.

Professional Support encourages feedback on this technical bulletin. Comments should be sent to pobrien@audit-scotland.gov.uk.

Headlines

This chapter provides brief headlines for the articles on technical developments and guidance in this technical bulletin, classified by the audit year to which they relate, and referenced to the paragraphs containing the main article.

Cross sector chapter	Paragraphs
2017/18 audit year	
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Health chapter	Paragraphs
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Cross-sectoral chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Scotland's Professional Support on any emerging risks, in the quarter that are relevant to all sectors.

It should be read by all external auditors. Information on developments and guidance from Professional Support in the quarter that are relevant to only one sector are covered in the relevant sector-specific chapter.

New support arrangements

1. Audit Scotland has restructured the way it provides support to appointed auditors. A new team has been created called Professional Support which has absorbed the Technical Services Unit and a previously separate team that provided support on audit approach to Audit Scotland's audit teams.

2. In summary, Professional Support will be responsible for
   - technical bulletins, technical guidance notes, and other technical support provided under the *Code of audit practice* to all appointed auditors
   - support to Audit Scotland teams on audit approach
   - good practice notes on financial reporting
   - quality control and monitoring of Audit Scotland audits
   - supporting professional leadership in Audit Scotland
   - counter-fraud work including the *National fraud initiative*.

Accounting developments

New guidance on materiality judgements

3. The International Accounting Standards Board (IASB) has issued guidance on making materiality judgements when preparing financial statements in Practice statement 2 Making materiality judgements.

4. An entity that chooses to apply the guidance is permitted to apply it to financial statements prepared from 14 September 2017. It therefore applies as guidance from 2018/19 to all public sector audits but could be adopted early.

5. The practice statement provides
   - an overview of the general characteristics of materiality
   - a four-step process for making materiality judgements

- guidance on how to make materiality judgements in specific circumstances.

6. The four step process is set out in paragraphs 33 to 65 of the practice statement but some key features are summarised in the following table:

Step	Specific actions for entities
1 Identify information with potential to be material (i.e. information users might require to make decisions)	Refer to requirements in international financial reporting standards (IFRS) as the starting point Consider users' common (rather than specific) information needs
2 Assess whether information is material (i.e. could the information reasonably be expected to influence users' decisions)	Consider quantitative factors – size of impact on financial performance or position compared with threshold Consider qualitative factors (entity-specific – characteristic of the transaction) including • Related party • Uncommon features • Unexpected variation Consider qualitative factors (external – context of the transaction) including • Geographical location • Sector • State of economy
3 Classify, characterise and present the information in the financial statements to make it understandable	Emphasise material matters Tailor information to the entity's own circumstances Describe the transactions simply and directly without omitting material information and without unnecessarily increasing length Highlight relationships between different pieces of information Provide information in an appropriate format, e.g. tabular Provide information in a way that maximises comparability Avoid duplication in different parts of the financial statements Ensure material information is not obscured by immaterial information
4 Review the financial statements to determine whether all material information has been identified	Assess whether information is material individually or in combination with other information Use knowledge and experience to identify whether all material information has been provided with appropriate prominence Consider the overall picture provided by the information provided from a wider perspective and in aggregate

7. Paragraphs 52 of 55 to the practice statement discuss the interaction of qualitative and quantitative factors at step 4 of the process. In summary, it suggests the following approach

- Set the quantitative threshold for numeric information first. If an entity identifies an item of information as material it does not need to consider other materiality factors.
- For information not identified as material after the quantitative assessment, the entity should assess the presence of qualitative factors. The presence of a qualitative factor lowers the threshold for the quantitative assessment. The more significant the qualitative factors, the lower those quantitative thresholds will be (perhaps down to zero).

8. **Auditors should** refer to this practice statement to inform their judgements on materiality when auditing the 2017/18 annual accounts.

Proposed changes to definition of material

9. The IASB has issued Exposure draft ED/2017/6 Definition of material which proposes amendments to *IAS 1 Presentation of financial statements* and *IAS 8 Accounting policies, changes in accounting estimates and errors* to clarify the definition of 'material'.

10. The proposed changes to the definition of material are summarised, along with the reasons for each, in the following table:

Proposed change	Reason
Replacing the phrase 'could influence' decisions of users with 'could reasonably be expected to influence'	This wording helps to address concerns that the threshold 'could influence' in the existing definition may be understood as requiring too much information, because almost anything 'could' influence the decisions of some users of the financial statements even if the possibility is remote.
Including 'obscuring information' in the definition	This clarification may also help to address the concern raised that the existing definition is sometimes perceived to focus only on information that cannot be omitted (material information) and not also on why it is unhelpful to include immaterial information. An entity should not reduce the understandability of its financial statements by obscuring material information with immaterial information, as this has a similar effect to omitting it. Accompanying guidance will clarify that material information can be obscured if it is not communicated clearly.
Replacing references to 'users' with 'primary users'	The current reference to 'users' could be interpreted as implying that an entity is required to consider all possible users when deciding what information to disclose. Supporting guidance will also be provided on who the primary users are.

11. The proposed definition of material is therefore:

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of a specific reporting entity's general purpose financial statements make on the basis of those financial statements.

12. Comments should be made by 15 January 2018 to commentletters@ifrs.org.

Proposed changes to definition of accounting policies and estimates

13. The IASB has issued Exposure draft ED/2017/5 Accounting policies and accounting estimates which proposes amendments to IAS 8 to help distinguish accounting policies from accounting estimates.

14. The IASB believes that the current definitions of accounting policies and changes in accounting estimates are not sufficiently clear which makes it difficult to distinguish between the two. The proposed amendments are summarised, along with the reasons for each, in the following table:

Proposed change	Further comment
Clarifying how accounting policies relate to accounting estimates	There changes are intended to clarify that accounting estimates are used in applying accounting policies. The accounting policy is the overall objective and the accounting estimates are inputs used in achieving that objective.
Revising the definition of accounting policies	To make the definition clearer and more concise, the proposals remove from the definition the terms 'conventions' and 'rules' and add 'measurement bases' instead of 'bases'.
Providing a definition of accounting estimates	The definition of a change in accounting estimate is to be removed, and replaced with a definition of accounting estimates.
Reference to inability to measuring items with precision	Clarification will be added that, when an item cannot be measured with precision, selecting an estimation technique constitutes making an accounting estimate.

15. The proposed definitions are therefore as set out in the following table:

Item	Definition
Accounting policies	The specific principles, measurement bases, and practices applied by an entity in preparing and presenting financial statements.
Accounting estimates	Judgements or assumptions used in applying an accounting policy when, because of estimation uncertainty, an item in financial statements cannot be measured with precision.

16. Comments should be made by 15 January 2018 to commentletters@ifrs.org.

Report on corporate reporting

17. The Financial Reporting Council (FRC) has issued its annual report on corporate reporting in 2016/17. The report provides the FRC's assessment of corporate reporting in UK companies based on reviewing the accounts. Although the reviews were carried out on private sector companies, many of the recommendations in the report (and in the separate reports covered in subsequent articles in this chapter) also apply to public bodies.

18. Beyond basic compliance with the legislative requirements and accounting standards, there are nine characteristics of corporate reporting which the FRC believes make for a good annual report. The characteristics are summarised in the following table:

Characteristic	Explanation
A single story	The strategic report (or management commentary/performance report in the public sector) should be consistent with the financial statements, and should explain significant points in the financial statements.
How the money is made (spent is more appropriate for public bodies)	The strategic report should give a clear and balanced account which includes an explanation of the entity's business model and the salient features of the performance and position.
What worries the board	The risks and uncertainties described in the strategic report should be those that genuinely concern the board/senior management team. The descriptions should be sufficiently specific that the user can understand why they are important. The report should also describe the mitigating actions taken to manage the impact. The links to accounting estimates and judgements should be clear.
Consistency	Highlighted or adjusted figures, key performance indicators and non-IFRS measures referred to in the strategic report should be clearly reconciled to the relevant amounts in the financial statements and any adjustments should be clearly explained, together with the reasons why they are being made.
Cut the clutter	Important messages, policies and transactions should be highlighted and supported with relevant context and are not obscured by immaterial detail. Cross-referencing and signposting should be used effectively, with repetition avoided.
Clarity	The language used should be precise and explain complex accounting and reporting issues clearly. Jargon and boiler-plate text should be avoided.

Characteristic	Explanation
Summarise	Items should be reported at an appropriate level of aggregation and tables of reconciliation should be supported by, and consistent with, the accompanying narrative.
Explain change	Significant changes from the prior period, whether matters of policy or presentation, should be properly explained.
True and fair	The spirit as well as the letter of accounting standards should be followed.

19. The report also describes the accounting and corporate reporting issues identified from the FRC's review. Some of the issues which also have relevance to public bodies are summarised in the following table:

Area	Examples of issues identified
Strategic report	Reviews of business not balanced Review did not discuss all relevant aspects of performance Review of financial position not comprehensive Reporting of principal risks and uncertainties unclear
Financial instrument disclosures	Descriptions of the risk classes and disclosure of the loan impairment process generic or unclear Insufficient explanation of why amounts payable accounted for as a contingent liability rather than as a financial liability Assessment of credit risk not explained
Fair value measurement	Unclear how the valuation techniques used Incomplete disclosure of significant unobservable inputs or sensitivities Basis for the categorisation of investments into the three levels of the fair value hierarchy unclear
Consolidation of subsidiaries	Non-consolidation of wholly owned special purpose vehicles
Related parties	Incomplete disclosure of loan balances, impairment provisions, rental and other service agreements with joint venture companies Unclear how the parties referred to in the disclosure are related to the entity Members of the management team excluded from disclosures of key management personnel

Report on estimates and judgements

20. The FRC has issued [Corporate reporting thematic review - judgements and estimates] on disclosures of significant accounting judgements and sources of estimation uncertainty. The report arises from a thematic review of companies' disclosure of these areas.

21. Paragraph 122 of IAS 1 requires disclosure of judgements made by management in applying an entity's accounting policies, other than those relating to estimates. Judgements that depend on management assumptions about the future are matters covered by the more wide-ranging disclosures of sources of estimation uncertainty required by paragraph 125 of IAS 1. The FRC expects judgements and estimates to be separately identified and the relevant disclosures to be provided for each. The differences between judgements and estimates are summarised in the following table:

Differentiation	Explanation	Examples
Judgement - those judgements that management makes when applying its significant accounting policies and that have the most significant effect on amounts that are recognised in the accounts	Not all judgements should be disclosed; they must relate to a significant policy and the judgement must have materially affected the reported amounts.	Examples of judgements that require to be disclosed are • when substantially all the significant risks and rewards of ownership of assets are transferred • whether, in substance, sales of goods are financing arrangements • whether or not to consolidate an investee entity • whether an entity is acting as principal or agent • whether the terms of a financial asset give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding.
Estimates - sources of estimation uncertainty relate to assumptions and estimates at the end of the current reporting period that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.	All three factors apply (i.e. significant risk, material adjustment, and within next financial year), which limits the number of items to be reported. Unnecessary disclosures run the risk of obscuring the most relevant information.	Examples of estimates that require to be disclosed include the • recoverable amount of classes of property, plant and equipment • selection of discount rate for pensions • provisions subject to the future outcome of litigation in progress • determination of depreciation methodologies.

22. The main expectations of the FRC set out in the report that also apply to public bodies are summarised in the following table:

FRC expectations	Further comments
Detailed descriptions of the specific, material judgements made in applying the accounting policies	Disclosures should not include judgements that do not have a material effect on the financial statements. This is unnecessary clutter which obscures the disclosures of the significant judgements. Entities should avoid boiler-plate text which refer to particular items in the accounts but do not give details of the areas of subjectivity or the basis for management's judgement. Disclosures should provide the background to the judgement, the technical reference, and the basis for the conclusion.
Disclosures should focus on those with a significant risk of a material change to the carrying value of assets and liabilities within the next year	Two-thirds of the companies reviewed disclosed estimates which did not appear to have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities.
Disclosures should be clear and specific, pinpointing the precise sources of estimation uncertainty and avoiding the use of boilerplate language	A third of the sample used boilerplate language when disclosing estimates. In many cases, the disclosures could apply to any entity and gave no additional useful information to users of the accounts. It was not always clear why the areas of estimation uncertainty disclosed were considered to be significantly difficult, subjective or complex, as required by IAS 1.
Specific amounts at risk of material adjustment should be disclosed, rather than just the value of the financial statement line item within which these are contained.	If the estimation uncertainty identified relates to a particular amount within a balance, users of the accounts need more than just a total amount in order to understand the effect.

FRC expectations	Further comments
The sensitivity of carrying amounts to assumptions and estimates, or the range of reasonably possible outcomes within the next financial year, should be disclosed	Most of the companies reviewed provided sensitivity or range of outcome disclosures for at least some of the estimates disclosed. However, these tended to only be in areas where this disclosure is required by another accounting standard. None of the companies reviewed provided sensitivity disclosures for useful economic lives, despite this being a commonly cited source of estimation uncertainty. Good disclosures explain where management's view sits within a range of outcomes, which is valuable for users and enables them to evaluate the possible effects of estimates on future accounts.

23. **Auditors should** refer to this report when checking bodies' disclosure of significant accounting judgements and sources of estimation uncertainty.

Report on pension disclosures

24. The FRC has issued Corporate reporting thematic review - pension disclosures to set out the findings from a review of pension obligation reporting by companies. The review arose from a need for increased transparency between an entity and its pension plans.

25. *IAS 19 Employee benefits* sets out disclosure objectives and explains the considerations that an entity must take into account when determining how they are to be met. Pension disclosures should enable users of the accounts to understand the relationship between the pension expense, the cash payments to the scheme, and the surplus or deficit. The FRC challenge entities who do not provide additional information which, although not specifically required, is necessary in order to meet the disclosure objectives of IAS 19.

26. The disclosures given to meet the requirements of IAS 19 should be accompanied by commentary in the strategic report.

27. The expectations of the FRC, along with examples of good practice, are set out throughout the report. In summary, the FRC expects entities to

    - explain the different pension valuation bases for accounting purposes compared with funding purposes
    - clearly quantify future funding requirements and describe the funding mechanisms adopted
    - give clear information about the maturity profile of their obligations
    - clearly explain their investment strategy and associated risks.

28. **Auditors should** refer to this report when checking relevant bodies' pension disclosures.

Auditing developments

Revised practice notes on pension schemes and charities

29. The FRC has issued revised versions of Practice note 11 The audit of charities in the UK and Practice note 15 The audit of occupational pension schemes in the UK. Practices notes are intended to assist auditors to comply with the requirements of international standards on auditing in the UK (ISAs (UK)), by providing additional contextual information on the application of those standards in particular circumstances or in specialised sectors. The revisions reflect

- the replacement of the 2009 ISAs (UK&I) with the 2016 ISAs (UK) (as explained in technical bulletin 2016/2 - paragraph 5)
- changes to *FRS 102 The financial reporting standard applicable in the UK*
- revisions to the pensions and charities SORPs
- changes in relevant legislation.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you noted the action recommended at paragraph 8 in respect of the practice statement on materiality?			
2 Have you noted the action recommended at paragraph 23 in respect of the report on disclosing judgements and estimates?			
3 Have you noted the action recommended at paragraph 28 in respect of the report on pension disclosures?			

Professional Support contact for cross-sectoral chapter

30. The contact in Audit Scotland's Professional Support for this chapter is Paul O'Brien, Senior Manager (Professional Support) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Local authority chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Scotland's Professional Support on any emerging risks, in the quarter that are relevant to the local authority sector.

It should be read by external auditors with appointments in the local authority sector. Auditors should also read the cross-sectoral chapter.

Guidance from Professional Support

Technical guidance notes

Audit of 2017/18 annual accounts

31. Audit Scotland's Professional Support has published Audit of 2017/18 annual accounts (local authorities) - technical guidance note 2017/10(LA) to provide guidance to all appointed external auditors on planning and performing the audit of 2017/18 local authority annual accounts.

32. While appointed auditors act independently and are responsible for their own conclusions and opinions, paragraph 108 of the *Code of audit practice* states that Audit Scotland has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement. Consistency in similar circumstances is important and therefore appointed auditors should consider such guidance.

33. The technical guidance note comprises a number of modules. The modules published to date, along with a brief summary of the contents, are set out in the following table:

Module	Content
Overview	Guidance on auditors' overall responsibilities for the annual accounts; the information on *The Local Authority Accounts (Scotland) Regulations 2014*; proper accounting practices that local authorities are required to follow; the application of ISAs (UK); presentation of authority-only financial statements; and accounting policies, estimates, and prior year errors

Module	Content
1 Property, plant and equipment	Each module highlights the risks of misstatement in each of the main financial statement areas, explains proper accounting practices applying to that area, and sets out actions for each risk that auditors should undertake to assess whether the local authority has followed those practices.
2 Provisions, creditors and accruals	
3 Financial instruments	
4 Retirement benefits	
5 Reserves	
6 Group financial statements	
7 Other financial statement areas	As for modules 1 to 6 but this module includes a number of financial statement areas including the expenditure and funding analysis, leases, grants, and intangible assets etc
8 Non-financial statements	This module covers the remuneration report, management commentary and annual governance statement. It explains auditors' responsibilities for these statements, sets out the different audit opinions required, highlights the main risks of misstatement, explains proper accounting practices applying to each statement, and sets out test procedures that auditors should undertake to assess whether the local authority has followed those practices.
10 Local government pension scheme (LGPS) fund accounts	This module provides guidance on applying the other modules to LGPS pension fund accounts, including further supplementary guidance.
11 Section 106 charity accounts	This module provides guidance on the audit requirement for section 106 charities and an update on progress in reducing the number of charities. It highlights the risks of misstatement in each of the financial statement areas and the trustees' annual report in a charity's statement of accounts, explains proper accounting practices, and sets out actions for each risk that auditors should undertake to assess whether the trustees have followed those practices.

34. Further modules will be published on integration joint boards and statutory objections to the accounts early next year.

35. Following extensive consultation with all auditors, the technical guidance note represents an agreed position on a range of complex technical issues and is a key document as auditors plan and perform the audit of local authorities' 2017/18 annual accounts.

36. For the purposes of the Audit Scotland website, all the modules have been combined into one document. The individual modules are also available from the relevant subject pages on the local authority site of the *Technical reference library*.

37. **Auditors should** use the technical guidance note when planning and performing the audit of the 2017/18 local authority annual accounts.

Valuation of property, plant and equipment

38. Module 1 of technical guidance note 2017/10(LA) highlights an issue regarding the revaluation of property plant and equipment. This arises from auditors identifying cases of material movements in value not being reflected in the relevant year resulting in a prior year error having to be corrected by a retrospective restatement in 2016/17.

39. Valuations are usually carried out as at 31 March, but there is no requirement for this, and the *Local authority capital accounting reference manual for practitioners* explains that authorities may use 1 April subject to the standard condition that the carrying amount at the end of the year does not differ materially from the current value at that date.

40. Where a valuation has been carried out at 1 April 2017, local authorities are required to consider whether there have been any movements in value during 2017/18 that should be reflected in the 31 March 2018 carrying value.

41. Where a valuation has been carried out at 1 April 2018, local authorities are required to consider whether this should be treated as an adjusting event in 2017/18 on the basis that it provides evidence of conditions that existed at 31 March 2018.

42. **Auditors should**

- encourage local authorities to carry out their revaluations of property, plant and equipment as at 31 March (as opposed to 1 April)
- where a valuation has been carried out at 1 April 2017, assess whether
  - the authority has considered whether there have been any movements in value during 2017/18 that should be reflected in the 31 March 2018 carrying value
  - the evidence that supports the authority's consideration is adequate
  - the authority has made necessary adjustments to the 31 March 2018 carrying value to reflect any movements that require to be reflected.
- where a valuation has been carried out at 1 April 2018, auditors should ensure they obtain the results and consider whether this should be treated as an adjusting event in 2017/18.

Number of section 106 charities

43. Local authorities have traditionally administered a significant number of small section 106 charities. Audit Scotland has advised auditors for several years to strongly encourage authorities to reorganise their charities through merging or winding them up. This would have the benefit of reducing the number of charities that authorities require to administer and account for, and that auditors require to audit.

44. While there has been some progress in authorities rationalising their number of charities, it appears there remains considerable scope for further reductions. The following table provides a summary of the total number of section 106 charities in 2016/17, and the progress in reducing the total numbers since 2013/14:

Year	Number of section 106 charities	Rationalisation progress
2013/14	384	-
2014/15	389	(5)
2015/16	307	82
2016/17	270	37

45. Appendix 1 to module 11 of technical guidance note 2017/10(LA) shows an analysis by council. While some councils have made significant progress, other councils have made limited or even no progress.

46. While the long term aim is to rationalise the number of section 106 charities, the overall number of separate sets of statements of accounts that are required can be reduced by the effective application of the connected charities provisions under The Charities Accounts (Scotland) Regulations 2006. Regulation 7 (as amended in 2010) permits a single set of accounts for charities if they have common or related purposes, or shared management (i.e. connected charities). This would be the case where charities have common trustees.

47. There were 91 sets of accounts in 2016/17 (down 12 from 103 in 2015/16). Appendix 2 to module 11 shows an analysis by council and indicates the extent to which the connected charities provisions were applied in 2016/17. The following table provides a summary in respect of the 24 councils with more than one charity:

Application of connected charities provisions	Number of local authorities
In full	11
Partial (but scope for further use)	2
None (but scope for use)	9
None (no scope for use)	2

48. **Auditors should**

- assess whether the local authority is making reasonable progress in rationalising the number of section 106 charities that it administers
- report the authority's progress in the 2017/18 annual audit report, with a recommendation to improve where the rate of progress is not considered acceptable
- encourage the local authority to make full use of the connected charities provisions in 2017/18, where there is scope to do so, so that the total number of sets of accounts that requires to be audited is minimised.

Accounting developments

General accounting

2017/18 accounting code guidance notes

49. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued guidance notes to assist in understanding the accounting requirements of the *2017/18 Code of practice on local authority accounting in the UK* (the accounting code). The guidance notes provide background to the 2017/18 accounting code's requirements and include detailed illustrations, but are not prescriptive.

50. The guidance notes have been amended (paragraphs I4 to I7 and the appendix in module 3) to reflect the change in the accounting code in respect of the disclosure of significant accounting policies. Paragraph 3.4.2.87 has been added to the accounting code to advise that when deciding whether a particular accounting policy should be disclosed as a significant accounting policy, a local authority must consider whether disclosure would assist users in understanding how transactions are reflected in its reported financial performance and financial position.

51. The code guidance notes explain that it is important for an authority to inform its users of the measurement basis or bases used in its financial statements because the basis on which an authority prepares the financial statements significantly affects users' analysis.

52. The example financial statements in the Appendix to module 3 of the guidance notes provide example accounting policies that authorities may wish to consider against their reporting

needs. The example assumes that each accounting policy is significant. However, it is important to note that the example accounting policies should not be treated as a template for the preparation of an authority's own accounting policies. Authorities should only present accounting policies that are significant to their financial statements and should choose the policies that are relevant to their own individual circumstances and needs.

53. Auditors may find it helpful to refer to the code guidance notes when auditing the 2017/18 annual accounts.

Leases

Consultation paper on adopting IFRS 16

54. At the time of preparing this technical bulletin, the CIPFA/LASAAC Local Authority Code Board (CIPFA/LASAAC) was about to issued a consultation paper on proposals for the accounting code's adoption of *IFRS 16 Leases* from 2019/20. IFRS 16 will have a substantial practical impact on local authority annual accounts. Local authorities need to ensure that they make effective preparations for its implementation and that they have adequate governance arrangements in place.

55. IFRS 16 removes the classifications of operating and finance leases under IAS 17 for lessees. It requires that a lessee recognises assets and liabilities for all leases with a term of more than 12 months unless the underlying asset is of low value. A lessee will recognise a

- right-of-use asset representing its right to use the underlying leased asset
- lease liability representing the lessee's obligation to make lease payments for the asset.

56. The following table summarises some of the questions expected to be included in the consultation along with a brief explanation of each one:

Summary of consultation paper
Do you agree with CIPFA/LASAAC's proposal to mandate the recognition exemption for short-term assets?
IFRS 16 permits entities to not apply its requirements for short-term leases, i.e. those that, at the commencement date, have a lease term of 12 months or less. CIPFA/LASAAC is proposing to mandate this exemption.
Do you agree with CIPFA/LASAAC's approach to low value assets in the exposure draft?
IFRS 16 also permits entities to not apply its requirements for low value leases. IFRS 16 confirms that the assessment of the value of the asset is based on the asset when it is new, regardless of its age at the time of being leased. The application guidance provides examples of what might typically be low value assets including laptops, tablet computers and small items such as office furniture and telephones. CIPFA/LASAAC is proposing to allow authorities to use this exemption.

Summary of consultation paper
Do you agree with the approach in the exposure draft to identifying a lease?
IFRS 16 defines a lease as a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. At the inception of the contract, IFRS 16 requires a local authority to assess whether it is or contains a lease. The key issues to be considered when making this assessment include the following • To be an identified asset, the asset must be explicitly or implicitly specifically identified in the contract. • A customer does not have the right to use the identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. • To assess whether the customer controls the use of the identified asset, it must assess whether the contract conveys throughout the period of use the right to obtain substantially all the economic benefits and service potential from the use of the asset and the right to direct the use of the identified asset. CIPFA/LASAAC do not propose adapting or interpreting IFRS 16 in any way in relation to the identification of the lease.
Do you agree with the approach in the exposure draft to the initial measurement of the lease asset and the lease liability?
At initial recognition the lease asset is measured at cost. The measurement of the right-of-use asset is initially directly related to the initial measurement of the lease liability with a number of potential adjustments including any lease payments made at or before the commencement date. At the commencement date, the lease liability is initially measured at the present value of the lease payments payable over the lease term.
Do you have any commentary on the approach to determining the interest rate implicit in the lease or the authority's incremental borrowing rate?
The lease liability is discounted at the rate implicit in the lease. If that cannot be readily determined, the lessee is required to use its incremental borrowing rate. Information from the private sector indicates that for many entities, it will be difficult to identify the interest rate implicit in the lease and therefore the incremental borrowing rate will need to be used. CIPFA/LASAAC consider that this may be the case for local authorities.
Do you agree with CIPFA/LASAAC's approach for the subsequent measurement of the right-of-use asset including the materiality based approach to current value measurement?
CIPFA/LASAAC proposes an approach under which longer-term property leases (e.g. 25 years) should continue to be measured at current value while short-term property leases be measured at depreciated historical cost as a proxy on a rebuttable presumption that this materially represents the current value of the asset.

Summary of consultation paper
Do you agree with CIPFA/LASAAC's approach to the subsequent measurement of the lease liability?
After the commencement date, subsequent measurement of the lease liability requires that a lessee • increases the carrying amount to reflect interest on the lease liability • reduces the carrying amount to reflect the lease payments made • remeasures the carrying amount to reflect any reassessment (e.g. change in lease term, revised discount rate) or lease modifications (i.e. change in the scope of the lease), or to reflect revised in-substance fixed lease payments. Subsequent measurement of lease liabilities is measured using the effective interest rate method so that the carrying amount of the lease liability is measured at amortised cost and interest expense is allocated over the lease term. CIPFA/LASAAC is of the view that there are no specific local government circumstances applying to the remeasurement of the lease liability requiring interpretation or adaptation.
Do you agree with CIPFA/LASAAC's approach to retrospective transition?
IFRS 16 offers entities the option of applying a practical expedient on the definition of a lease. An entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted • to apply IFRS 16 to contracts that were previously identified as leases applying IAS 17 and *IFRIC 4 Arrangements containing a lease* • not to apply IFRS 16 to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4. CIPFA/LASAAC is proposing to allow this practical expedient but is not mandating it to allow local authorities to take this decision locally. IFRS 16 provides for two approaches to transition, i.e. full retrospective restatement or recognising the cumulative effect of initially applying the standard at the date of initial application as an adjustment to reserves (preceding year information is not restated). CIPFA/LASAAC is proposing to mandate the second option.
Do you agree with CIPFA/LASAAC's proposal in relation to the transitional approach to measuring the right-of-use asset for those previously classified as operating leases?
For leases previously classified as operating leases, IFRS 16 offers the lessee the choice of measuring the right-of-use asset at • its carrying amount as if IFRS 16 had been applied since the commencement date, or • an amount equal to the lease liability adjusted by the amount of any prepaid or accrued lease payments relating to that lease before the date of initial application. CIPFA/LASAAC is proposing to use the second option as it is of the view that it is easier to estimate and more understandable for the users of the financial statements.

Financial instruments

CIPFA/LASAAC statement on IFRS 9

57. CIPFA/LASAAC has issued a statement which confirms it has approved the full adoption of *IFRS 9 Financial Instruments* into the accounting code and therefore this will apply to local authority annual accounts from 2018/19.

58. One of the key impacts of IFRS 9 will be that gains and losses arising from changes in the fair value of some categories of investments will be recognised in the comprehensive income and expenditure statement, with a consequent impact on the general fund. This is a particular issue for the various collective investment vehicles that form part of some local authorities' investment portfolios.

59. The statement advises that representatives from central and devolved governments, including the Scottish Government, have confirmed that they would be willing to consider representations from local authorities for a statutory mitigation.

Auditing developments

2016/17 financial overview

60. The Accounts Commission issued a report to provide a high-level, independent analysis of councils' financial performance and position in 2016/17. Financial overview 2016/17 is aimed primarily at councillors and senior council officers as a source of information and to support them in their roles.

61. The primary sources of information for the report are councils' audited accounts and the 2016/17 annual audit reports, supplemented with other information supplied by auditors and councils.

62. A key message is that management commentaries vary in how clearly they explain councils' financial performance, but overall there remains scope for improvement. It is the Accounts Commission's view that councillors have an important role in ensuring that the management commentary effectively tells a clear story of financial performance and can be understood and scrutinised by a wide audience. The story at the end of the year should be produced from regular reports provided to councillors throughout the year.

63. The report also highlights the importance of keeping provisions and contingent liabilities under review.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Are you using the technical guidance note referred to at paragraph 37 when planning and performing the audit of the 2017/18 local authority annual accounts?			
2 Have you noted the action recommended at paragraph 42 in respect of the valuation of property, plant and equipment?			
3 Have you noted the action recommended at paragraph 48 in respect of the section 106 charities?			

Professional Support contacts for local authority chapter

64. The contact in Professional Support for this chapter is Paul O'Brien, Senior Manager (Professional Support) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Health chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Professional Support on any emerging risks, in the quarter that are relevant to the health sector.

It should be read by external auditors with appointments in the health sector. Auditors should also read the central government sector and cross-sectoral chapter.

Guidance from Professional Support

Good practice notes

Reporting financial performance

65. Audit Scotland's Professional Support has issued a good practice note to assist NHS boards in improving the reporting of financial performance and outturn in their performance reports. The note is based on a review of all boards' 2016/17 disclosures of that information to identify instances of good practice and areas for improvement.

66. There are lessons for boards, auditors and the Scottish Government to ensure that in future information disclosed meets disclosure requirements, is presented consistently, and is clear, concise, and free from misstatement.

67. The note sets out some key messages including recommending that boards

- provide a clear explanation of the financial performance resource limits and the purpose of the memorandum for in year outturn
- ensure narrative descriptions are consistent with the amounts being described
- check that figures and terminology are internally consistent
- explain where figures have been prepared on different bases.

68. **Auditors should** encourage boards to refer to this good practice note when preparing their 2017/18 financial performance and outturn disclosures.

Accounting developments

Revenue recognition

Guidance on 2017/18 cost recovery scheme

69. The UK Department of Health has issued Guidance on the application of the NHS injury cost recovery scheme for 2017/18 which sets out the process for boards to recover costs incurred

on treating injuries under the *NHS Injury cost recovery scheme*, and how this should be recorded in the financial statements.

70. Day to day operation of the scheme is undertaken by the Cost Recovery Unit (CRU) of the Department of Work and Pensions. The CRU notify boards of claims using form NHS2, which asks for basic treatment details. The form is used to calculate how much is payable, using an average tariff system.

71. Boards will know on completion of the NHS2 how much they are due to receive when the claim is settled (net of impairment for non-payment equal to 22.84%). They should recognise income and a debtor at the point the form has been received and they have confirmed that treatment has been provided. Initially this should be recognised in long term debtors and transferred to short term debtors after one year.

72. **Auditors should** assess whether boards are recognising income and debtors for cost recoveries in accordance with this guidance in 2017/18.

Auditing developments

2016/17 overview report

73. The Auditor General for Scotland has issued NHS in Scotland 2017 to provide the results of the annual review of how NHSScotland is performing. The report is in the following two parts

- Part 1 of the report considers the financial and wider service performance in the sector.
- Part 2 of the report focuses on the impact of some of the significant changes that the sector is undergoing, including health and social care integration.

74. As with last year, the majority of NHS boards had to use short-term measures to operate within their resource limits. These included:

- receiving brokerage and late allocations from the Scottish Government
- reallocating capital funding to revenue funding to allow it to be used to cover increasing operational costs
- making one-off accounting adjustments, such as releasing surplus holiday pay accruals and insurance rebates.

75. The report also states that the majority of NHS auditors reported that integration joint boards submitted late financial information to NHS boards for the 2016/17 accounts process. Therefore relevant financial information was not available to boards and auditors at the appropriate time for inclusion in the draft accounts.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you noted the action recommended at paragraph 68 in respect of the good practice note of reporting financial performance?			
2 Have you noted the action recommended at paragraph 72 in respect of the cost recovery scheme?			

Professional Support contact for health chapter

76. The contact in Professional Support for this chapter is Neil Cameron, Manager (Professional Support) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.